The relevance of the recent McWilliams v. Norton Finance (UK) Limited (in liquidation) ruling for UK lenders and brokers

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Judgement was handed down on this appeal by the Court of Appeal on 11 March 2015.

This was the first time an appellate court had looked at the issue of disclosure of commission since the landmark Supreme Court decision in Plevin v. Paragon Finance in November 2014. See *(AFI article on this November 2014*).

The Facts

This concerned a secured loan of £25,000 (not CCA regulated) with single premium Payment Protection Insurance (PPI) of £3,745.

It was an information only (or non-advised) sale. The loan was to consolidate existing debts and finance a conservatory. Norton Finance (Norton) was paid a broker fee of £750 and a completion fee of £500.

Norton was:

• a member of FISA;

• authorized by the FSA for general insurance intermediation; and

• an independent broker unconnected with the lender.

Norton was not present or represented at the hearing of the appeal but it had prepared a skeleton argument which the court read.

Commission Level and Disclosure

Two separate broker commissions were paid:

• £2,675 for the loan; and

• £1,688.25 for the PPI.

However it was said these commissions were paid by the lender not to Norton itself but rather to another credit broker (Fintel) which advertized for loans for Norton and other credit brokers.

The commission in McWilliams was 45% whilst in Plevin it was 72%.

The Court of Appeal considered these borrowers “vulnerable”. Mrs. McWilliams has multiple sclerosis. The court decided that the amount of commission earned by Norton should have been disclosed to them. The FISA booklet sent to the borrowers had a statement in general terms that commission would be paid. The court said this was not enough and held there was a fiduciary duty on Norton which had been breached. As a result the Court of Appeal ordered all commissions to be refunded with 5% interest.

Key issues for brokers addressed by the Court of Appeal

The Court of Appeal had to consider two issues:

• Was there a breach of fiduciary duty?;

• Should the amount of the commission earned by the broker have to be disclosed?

The starting point is an earlier Court of Appeal ruling in Hurstanger Limited v. Wilson [2007] 1 WLR 2351. There on an £8,000 second charge loan, the introducing broker was paid a fee of £1,000 for arranging the business and this was made clear to the borrowers. However, the broker was also paid an additional commission by the lender at completion of £240 but this payment was only referred to in general or vague terms in the documentation pack the borrowers received.

In possession proceedings, following default on this sub-prime lending various technical points were raised. The trial judge:

• had evidence from the lender that it was necessary to pay commissions in a highly competitive market;

• found nothing unusual about the circumstances in which commission was paid; and

• ruled the payment to the broker was not secret because documents given to borrowers said a commission would be paid.

In Hurstanger, the issue of whether there was a fiduciary duty at all was never argued before the Court of Appeal because it was agreed it existed. Nevertheless Tuckey LJ ruled that:

"The contract of retainer contained the usual implied terms, but the relationship created was obviously a fiduciary one. 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. Yet he agreed that he would be paid a commission by the other party to the transaction which his clients had retained him to procure. By doing so he obviously put himself into a position where he had a conflict of interest. The defendants were entitled to expect him to get them the best possible deal, but the broker's interest in obtaining a further commission for himself from the lender gave him an incentive to look for the lender who would give him the biggest commission."

In McWilliams the Court of Appeal further extended the scope of fiduciary duties on insurance and credit brokers. It applied the Privy Council ruling in Arklow Investments v. MacLean [2000] WLR 594 where it was held that there was an obligation not to exploit or take advantage of the position of the fiduciary at the expense of the principal. It held a principal is entitled to the single-minded loyalty of his fiduciary.

As a consequence in McWilliams it ruled that the broker did not have informed consent from the borrowers to receive and keep any commission at all because the borrowers were vulnerable and unsophisticated. As the amount of commission earned by the brokers was not disclosed the court ordered all the commission to be repaid to the borrowers.

What now?

The asset finance industry had until now proceeded on the basis that independent 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 that commission. Where consent is not obtained then commission payments may have to be repaid.

Problem areas for brokers

Ordinarily a claim in contract needs to be brought within six years. However, brokers may now start to see claims being made against them relying on the McWilliams ruling going back much further than this. The reason for this is that section 32 of the Limitation Act 1980 deals with "concealment". Where a court rules that this applies, the effect is that the six-year limitation

period is postponed. Brokers should not be over hasty in destroying records of past sales dating back from 2009 or earlier.

Many banks and lenders as well as being a creditor are also a broker for arranging insurance – often with another company in their group. This could mean that lenders themselves may also find themselves owing a fiduciary duty. It is not clear how vulnerable or unsophisticated a customer needs to be for the fiduciary obligations to arise. The commission here was 45% but it is not clear what will be the position where commissions of less that this amount are received by brokers.

Comments

For business written after 1 April 2014, there is express provision in the Consumer Credit part of the Financial Conduct Authority's handbook. CONC 4.5.3R says that a credit broker must disclose to a customer the existence of any commission or fee payable by a lender where knowledge of the existence or amount of the commission could actually or potentially affect the broker's impartiality or have a material impact on the customer's decision.

However the McWilliams' decision not only gives retrospective affect to this part of CONC it also widens its scope too. Brokers will need to:

• review documents to ensure there is CONC compliance;

• make clear to end users the basis of their remuneration; and

• obtain informed consent from end users to retain commission.

Brokers are vulnerable to claims on other such cases where a claim cannot be made against a lender itself. Brokers are likely to see an increasing number of claims for breach of fiduciary duty on any cases where an undisclosed commission has been paid.

Brokers are especially vulnerable to these claims where an "unfair relationship" claim cannot be made against the lender because the customer is a limited company, or the lending is for business purposes and/or over £25,000, or where the lending has been repaid before April 2008. It would seem claims will have to be settled if the McWilliams criteria are met.

Norton is in liquidation and it seems unlikely there will be a final appeal to the Supreme Court of the United Kingdom. As this judgment is from the Court of Appeal it is binding on all County Courts in England and Wales.

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