ASIC

Australian Securities & Investments Commission

Distorting Incentives paid to intermediaries in the credit market

FinCoNet General Meeting 2013
Lisbon, Portugal

Ways Conflicts may disadvantage consumers

- Consumers being encouraged to obtain loans that they are not able to repay, or not without undue hardship;
- Intermediaries, with or without the complicity of the consumer, engaging in loan application fraud by misstating the consumers financial position on the loan application;
- Intermediaries recommending loans that pay the highest commission to them even if they are not the best value or most suitable for the borrower; and
- Brokers negotiating loan terms that prioritise their commission rather than the consumer's interests.

Types of Lenders Reviewed

- banks with specialist car finance divisions
- finance companies without brand affiliation to a particular car manufacturer
- finance companies with brand affiliation to one or more car manufacturers
- credit providers who directly sell their own finance products to consumers
- credit providers who predominantly or exclusively used others to sell their finance products

Commercial relationships

Car finance is available throughout Australia from licensed credit providers:

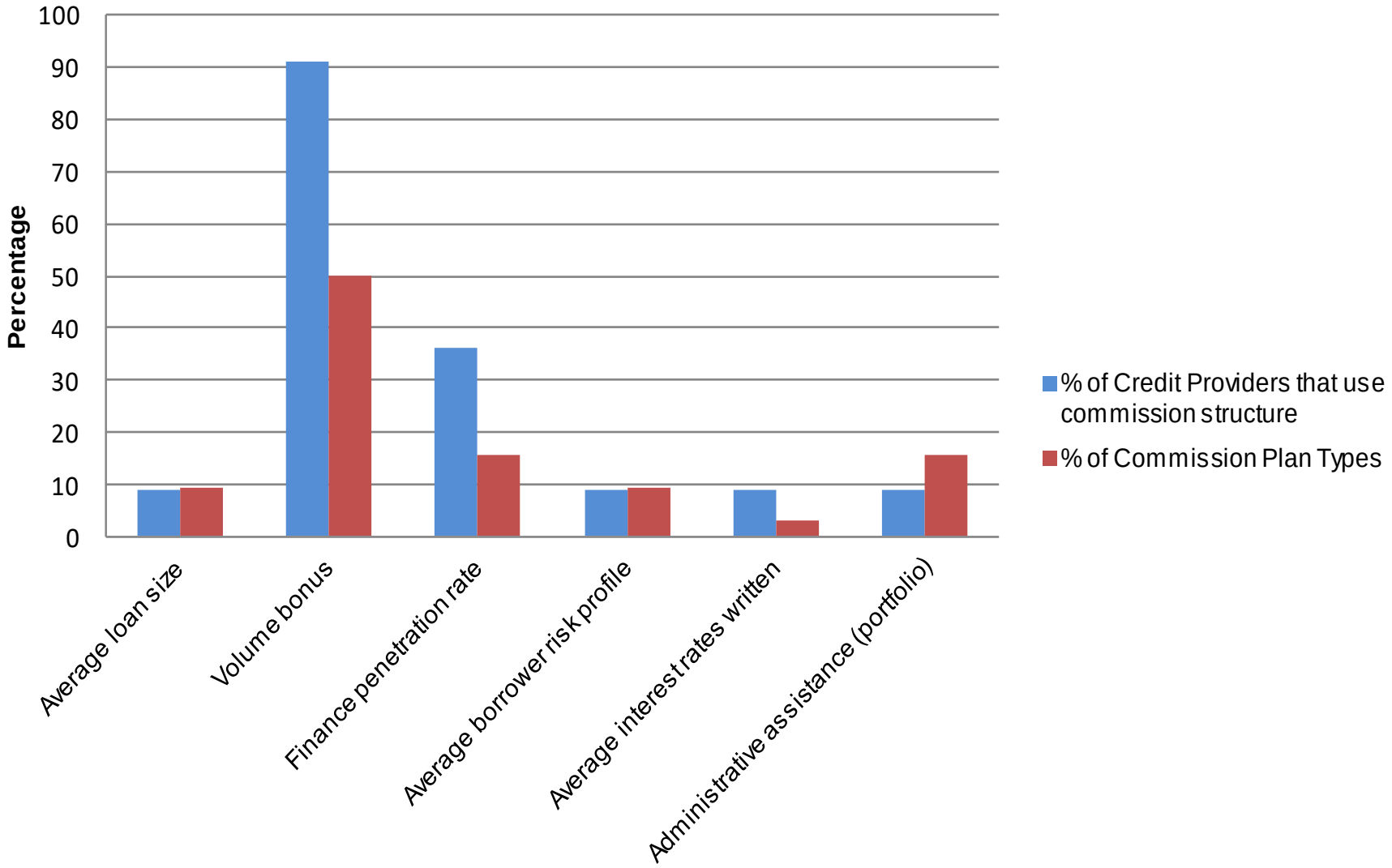
- directly through employees in their branch networks, call centres and online
- through ‘intermediaries’ such as
  - brokers (either licensed or acting as a credit representative for another person)
  - aggregators
  - exempt point-of-sale representatives located in car yards and dealerships.

Tier 1 and Tier 2 Commissions

Tier 1: Calculated on a per-contract basis. Dollar amounts known at the time of the contract (ascertainable).

Tier 2: Calculated on a portfolio of loans written during a preceding period. Paid on top of Tier 1 Commission. The dollar amount is not know at the time of the contract (unascertainable).

Distribution of Tier 2 commissions



Typical Formula for Flex Sharing

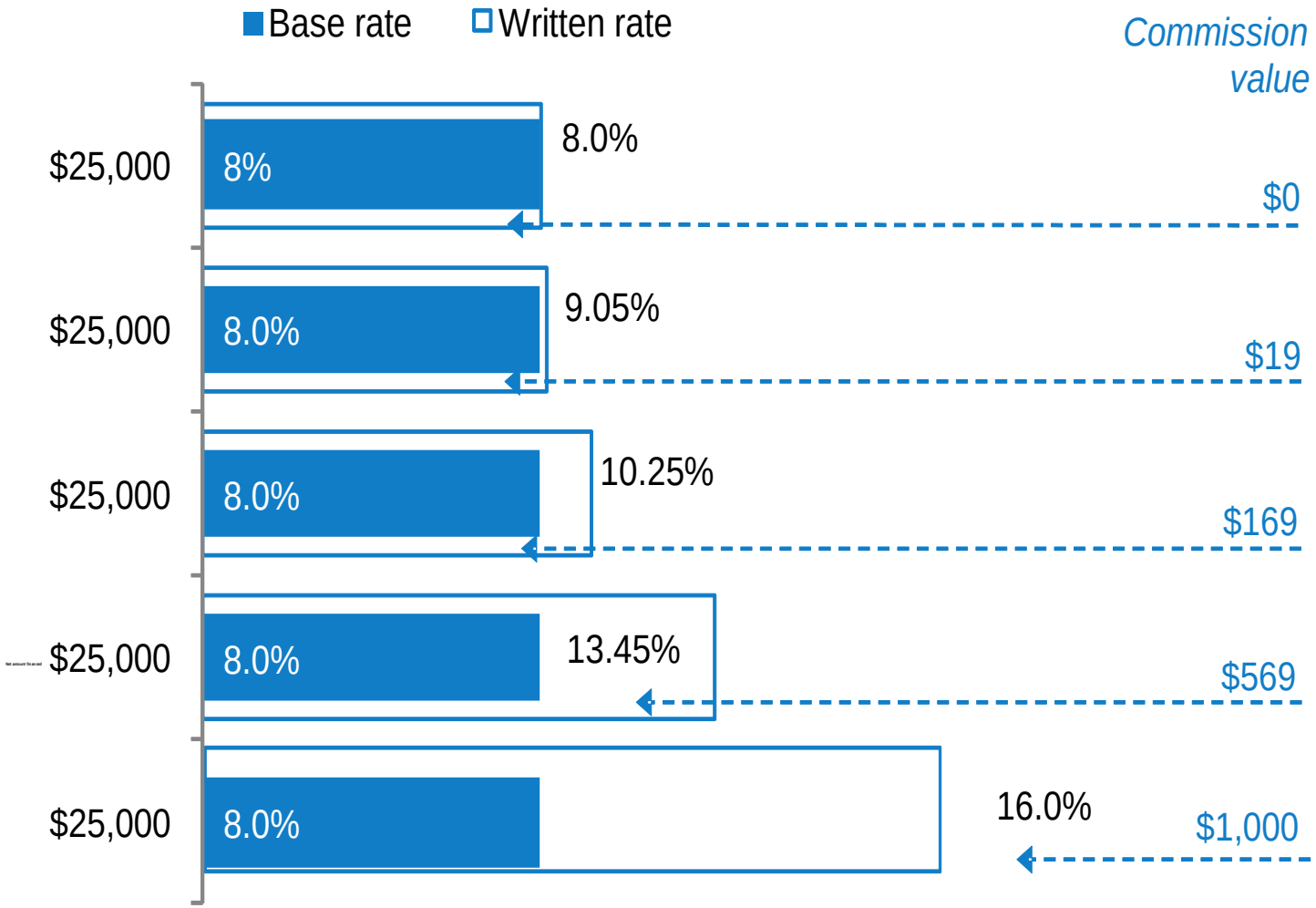
$$(WR - BR)\% \times NAF = \text{Flex amount}$$

where:

- WR is the written percentage rate of interest on an individual contract
- BR is the base percentage rate of interest set by the credit provider
- NAF is the net amount financed.

Flex amount is shared between Lender and Broker according to agreed percentage

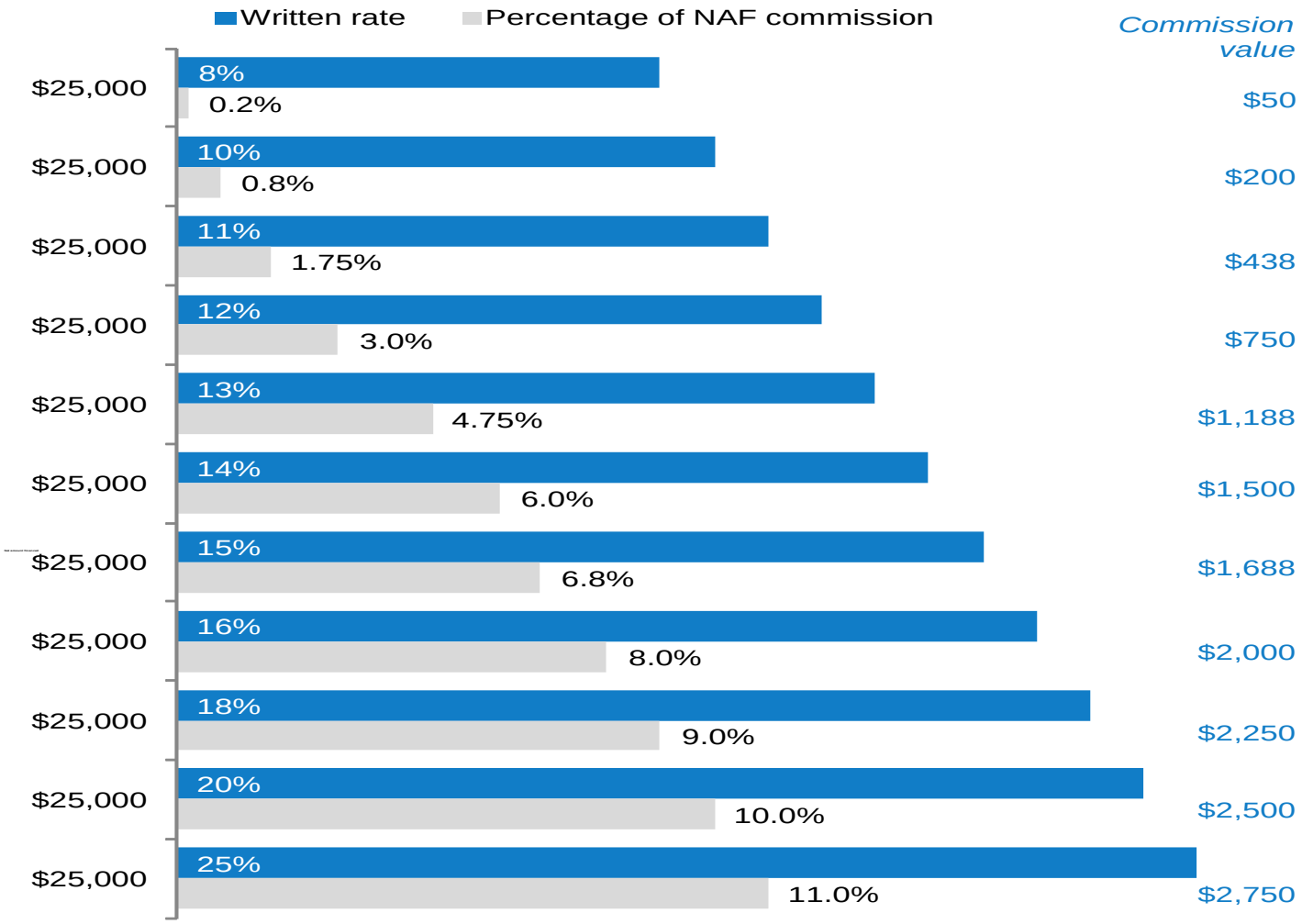
Flex Sharing example



Financial impact of flex sharing arrangements

Interest rate	What the consumer pays	What the credit provider earns	What the intermediary earns
8% (base rate)	$5,415 interest	$5,415 interest – $0 commission + $0 flex retained	nil
16% (cap rate)	$11,477 interest	$11,477 interest – $1,000 flex commission + $1,000 flex retained	+ $1,000 flex commission
Difference	$6,062 more	$6,062 more	$1,000 more

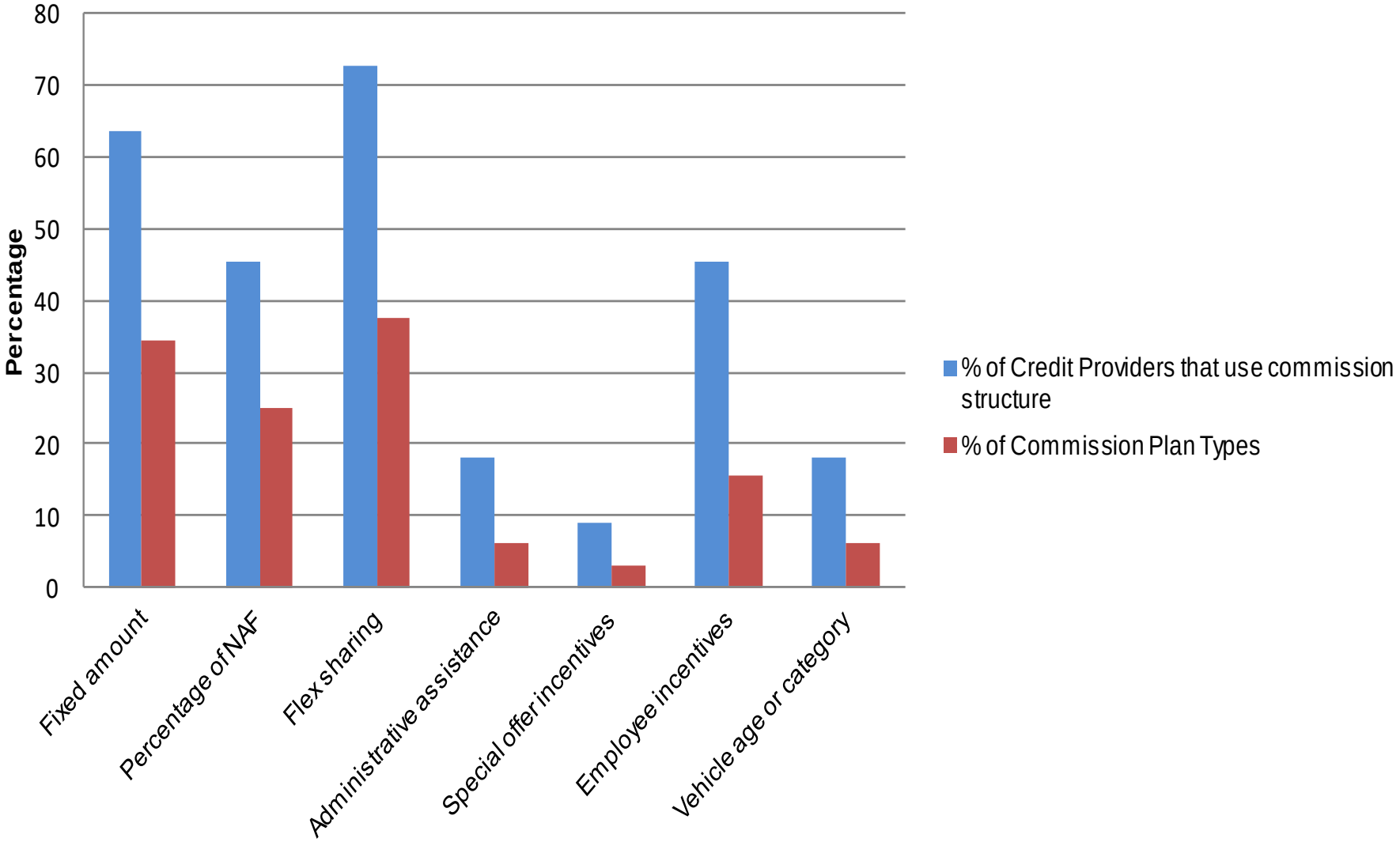
Percentage of NAF commission rising with interest rate



Financial impact of percentage of NAF commissions rising with interest rate

Interest Rate	What the consumer pays	What the Lender earns	What the intermediary earns
8%	$5,415 interest	$5,415 interest – $50 Commission	$50 commission
25%	$19,027 Interest	$19,027interest – $2,750 Commission	$2,750 Commission
Difference	$13,612 more	$10,912 more	$2,700 more

Distribution of Tier 1 Commissions



Possible Regulatory Action

- Law reform
- breach of statutory duty to act honestly, efficiently and fairly
- breach of conflict of interest provisions
- Unjust contract
- Unfair conduct
- Unconscionable
- Misleading or deceptive conduct.