Law Council OF AUSTRALIA

Business Law Section

Via email: flexcommissions@asic.gov.au 11 April 2017

Dear Sir or Madam,

Flex commission arrangements in the car finance industry
Response to Consultation Paper 279

Introduction

This submission is made by the Financial Services Committee of the Business Law Section of the Law Council of Australia (**Committee**) in response to Consultation Paper 279 *Flex commission arrangements in the car finance industry* published by the Australian Securities and Investment Commission (**ASIC**) in March 2017 (**Consultation Paper**), to which is attached draft ASIC Credit (Remuneration Arrangements) Instrument 2017/XX (**Draft Instrument**).

Although ASIC requested submissions by 27 March 2017, we would be grateful if ASIC would nevertheless consider the points raised below.

Our Committee supports the policy response of ASIC to the use of flex commission arrangements in the car finance industry as outlined in the Consultation Paper.

However, we submit that there are some technical issues that should be considered in implementing the Draft Instrument and ASIC's policy (as stated in the Consultation Paper).

1. **Scope of ASIC's delegated power**

   We have material doubts about the power of ASIC to create a new prohibition of particular conduct that is not presently regulated, and to impose criminal penalties and civil penalties, by an instrument such as the one proposed in the form of the Draft Instrument.

   Relevantly, ASIC's power to make legislative instruments under the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**) is set out in section 109(3)(d) of that Act and provides as follows:

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> *"ASIC may, by legislative instrument… declare that provisions to which [the relevant] Part [of the NCCPA] applies apply in relation to a credit activity… as if specified provisions were omitted, modified or varied as specified in the declaration."*

That section gives ASIC the power to omit, modify or vary a specified provision of the NCCPA. That power does not extend to imposing any additional obligation, requirement or prohibition in respect of a credit activity.

Under the Draft Instrument, ASIC will create a new prohibition that does not exist in the NCCPA or *National Consumer Credit Protection Regulations 2010* (Cth), and will impose criminal and civil penalties for breach of that prohibition. This appears to be beyond the power delegated to ASIC in section 109(3)(d) of the NCCPA.

For similar reasons, it would not be possible to introduce a prohibition of this character by regulations made under the power contained in in section 110(c) of the NCCPA.

To introduce a new section 53A of the NCCPA, the appropriate course would be to amend the NCCPA itself by an Act of Parliament.

By way of analogy, ASIC's power under the *Corporations Act 2001* (Cth) (**Corporations Act**) does not extend to introducing a prohibition on the provision of certain remuneration.

Following investigations by ASIC into the financial advice and life insurance industries, the ban on "conflicted remuneration" (as defined in the Corporations Act) was introduced by Acts of Parliament. That is, the ban on conflicted remuneration contained in Part 7.7A of the Corporations Act was introduced for most financial products under the *Corporations Amendment (Future of Financial Advice) Act 2010* (Cth), and amended under the *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2016* (Cth) (**LIF reforms**) to apply to life risk insurance products. ASIC's power to regulate remuneration arrangements is specifically provided for in section 963BA (introduced under the LIF reforms). That power is limited to specifying the acceptable benefit ratio and clawback for remuneration arrangements that will fall within the exemption under section 963B(1)(b)(iii) (as amended under the LIF reforms).

2. Scope of Draft Instrument

In its scope of application, the Draft Instrument is not limited to the car finance industry.

We are not aware of evidence of conduct outside the car finance industry in the manner of use of flex commissions that would warrant imposing a prohibition of flex commissions outside that industry. Furthermore, we are not aware of any consultation process relating to flex commissions outside the car finance industry.

There are a number of other industry sectors that distribute credit products (for example, retailers of furniture and appliances), and because of the wide terms of application of the Draft Instrument, the proposed prohibition may have unknown and unintended impacts on pricing and remuneration models that are adopted in those industry sectors.

We therefore query whether it is intended or desirable to prohibit conduct outside the car finance industry in the absence of evidence of relevant inappropriate conduct and without consultation with other industry sectors that will be affected by the proposed reform.

3. The ban should not apply to special purpose funding entities

In its present form the Draft Instrument is framed as a prohibition on payment of flex commissions by an Australian credit licensee.

In some other closely related contexts, a licensee has been defined to include a credit provider that is able to rely on an exemption from the licensing regime. For example, the responsible lending conduct obligations contained in Chapter 3 of the NCCPA apply to special purpose entities that rely on an exemption from the requirement to hold an Australian credit licence (Chapter 3 of the NCCPA, including section 128, as amended by Schedule 3 of the NCCPR. The effect of this is that a special purpose funding entity (which is not an Australian credit licensee) must comply with responsible lending conduct obligations (as amended by the NCCPR), which is an acceptable policy outcome.

In practice, many credit providers are special purpose funding entities relying on regulation 23B or 23C of the NCCPR (each an **SPV Exemption**) because this facilitates access to options for funding of loans that result in greater competition and lower costs of funding than some other credit providers. This therefore benefits consumers.

To rely on an SPV Exemption, a special purpose funding entity must not have employees of its own, and must have a servicing agreement with a licensee. Contemporary securitisation arrangements are built on this type of transaction structure.

If the prohibition on the payment of flex commissions is extended to include payments made by special purpose funding entities, we consider that there may be some unintended consequences. This is because, in a typical funding arrangement of a special purpose funding entity, any amount remaining after payment of liabilities and costs of the special purpose funding entity is often payable to the licensee, with whom the special purpose funding entity has entered into servicing agreement, as a fee under the servicing arrangement. The special purpose funding entity does not take the profits of the business it writes.

Of course it is the licensee that manages the business of the special purpose funding entity, and it sets the interest, fees and charges payable under a credit contract. When looked at from above, the credit provider (being a special purpose funding entity) could be characterised as a funding mechanism for the business of the licensee, and on that basis we consider that it is appropriate for the licensee to take any benefit remaining after the liabilities and costs are paid.

It follows that we believe the prohibition on payment of flex commissions should not apply to a special purpose funding entity.

4. **Related bodies corporate should be exempt**

   For similar policy reasons to those discussed in section 2 above, we submit that the prohibition on payment of flex commissions should not apply to flex commissions paid by a licensee to a related company. This would respect the commercial arrangements for allocation of responsibilities (and offering of services) between members of a corporate group, and the methods for decision-making adopted within a group. In our view it should not affect the ultimate pricing to a consumer.

If you have any questions regarding this submission, in the first instance please contact the Committee Chair, Henrietta Thomas, via email: Henrietta.thomas@hsf.com or via phone (03) 9288 1053. The Committee would welcome the opportunity to present in person or to be involved in further consultation as the consultation proceeds.

Yours faithfully,

Teresa Dyson, Chair
Business Law Section