Implications and Challenges of the Clawback Clause for Finance Brokers: An In-depth Analysis

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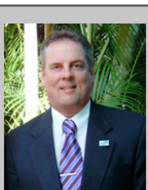

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Background:

This White Paper has been compiled due to a prevailing sense of frustration arising from the Finance Industry Broker Bodies, government departments, and ASIC's lack of proactive measures and motivation in effectively tackling the systemic issue of clawbacks within the Finance Broker Industry.

In my extensive 27-year tenure in the finance industry, I have witnessed and adapted to numerous transformations. For a significant portion of my career, I served as a senior Business Development Manager/Lender at a prominent bank, contributing seven years of valuable experience. Additionally, I possess a wealth of 20 years dedicated to the field of broking, having worked with diverse finance companies, franchises, and established my own ventures. Throughout my professional journey, I have provided guidance and mentorship to numerous brokers, nurturing their growth and development. Beyond finance, I have also gained experience to the realms of retail, entertainment, and business coaching. My qualifications encompass a wide range of certifications in various domains. As an individual, I hold a deep-seated commitment to ethical conduct and remain resolute in confronting and rectifying any injustices that come my way.

This white paper subsequently serves as an expression of my perspectives and the actions I have personally undertaken to investigate this significant industry problem. I have engaged in direct conversations with prominent figures within the industry, some of whom have advised me against taking any action. Furthermore, I have networked with numerous brokers around Australia, all of which have felt the pain of clawbacks.

Given my personal access to thousands of Facebook and LinkedIn users, along with a database comprising over 600,000 business owners throughout Australia (coupled with direct contact with thousands of finance brokers), I fail to observe any significant outcry or decisive actions being taken to address the unlawful practice of "Clawbacks." Within the finance industry. It seems that finance professionals tiptoe around this matter, treating it almost like a taboo term. The issue currently unfolding stems from industry "advocates" attempting to resolve the problem internally, politely appealing to the banks for a solution or a degree of leniency. Needless to say, this approach is unlikely to yield any substantial results.

The Assistant Treasurer, Stephen Jones MP, has expressed his curiosity regarding evidence pertaining to whether lenders profit from clawing back broker commissions. This statement / expression, in my opinion, is quite marginalizing, as it is evident that lenders do indeed benefit from clawbacks, as explained further in this white paper. Additionally, his expression of being "interested to see" suggests to me that this inquiry may not lead to any significant progress. (lip service)

When I presented a clawback complaint to the Australian Financial Complaints Authority (AFCA), they conveniently evaded the issue by stating that it falls outside the purview of their "rules" (for additional information on AFCA, please refer to the relevant section in this white paper). Prominent legal firms specializing in class actions have sidestepped my inquiries, citing limitations in their capacity to handle a large-scale case of this nature. It is disheartening to witness that ASIC, the regulatory authority, has essentially endorsed the practice of clawbacks. Furthermore, the implications of the Best Interests Duty (BID) seem to have been disregarded. These circumstances undoubtedly contribute to my growing frustration.

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Finance brokers with less than a decade of experience in the industry have never known a world without clawbacks, and some have come to accept this as an enduring reality. I have encountered brokers who accept clawbacks as an integral aspect of operating a broker business, incorporating associated costs into their financial considerations. However, the challenge arises when one cannot predict which loans will be closed within a two-year timeframe. Some brokers opt to set aside funds to cover potential clawbacks, while others choose to implement upfront fees. Regardless of their individual perspectives, it is an undeniable fact that clawbacks are unlawful, as will be explained upon in the subsequent sections of this document.

Definition of a Claw-Back as applied to the Finance Broker Industry

What is the legal definition of a "clawback" within the finance industry? Clawback is a fee charged by the banks to mortgage (and Finance) brokers for home loans (and other loans) that are prepaid or refinanced within two years of settlement. The amount of fees varies from lender to lender; however, most banks charge (clawback) the full amount of the upfront commission paid to the broker if the loan is prepaid in the first year and 50% of the fee within a two-year period. Prior to 2006, these alleged Lender “Loan mortality “ losses (with undisclosed exact figures by lenders) were included as part of the various expenses associated with the operational costs of said lenders. Losses incurred due to early termination of loans were considered a customary aspect of business for banks and lenders, and these losses were factored into the fees and interest rates charged.

Around 2001, lenders initiated the practice of imposing Deferred Establishment Fees (DEF) on borrowers who closed their loan facility within the initial two years. This measure aimed to recover early closure costs and enhance profits and returns for shareholders. Existing interest rates and fees, (incorporating a standard loan mortality rate) which were already in effect to mitigate such losses, remained unchanged, effectively resulting in a "double dipping" scenario within consumer contracts. The purpose of DEF was to offset the expenses incurred by the bank or lender during the loan establishment process in the event of early closure. Additionally, DEF provided the advantage of making the loan more "sticky" for the bank, ensuring a minimum two-year commitment from the client to guarantee profitability. Consumers were essentially compelled to remain with the bank for this duration or face substantial exit fees.

In 2011/2012, the government recognized the unfairness of lenders charging DEF fees to consumers and deemed it unconscionable. Consequently, legislation was enacted to prohibit this practice. However, in 2012, the landscape surrounding early exit fees underwent a shift, creating an opportunity for lenders to transfer the "loss" onto brokers on a significant scale. The absence of specific legislative measures to prevent burdening small broker businesses allowed for the repackaging of DEF as "Clawbacks," thereby transferring the associated fees and expenses to brokers.

Clawbacks have been present in the finance broker industry since approximately 2006, albeit in rudimentary forms. However, around 2011/2012,(as mentioned above) the banks and Lenders implemented a full clawback clause in most agreements between banks, lenders, and brokers. This development arose from:

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a) New Legislation to prevent Banks and Lenders from recouping establishment fees from Consumers through “deferred Establishment Fees” (DEF). The Government at the time legislated that this was an unconscionable practice, hence outlawing the practice.
b) Around this same time, when Banks and lenders were prohibited from charging consumers a DEF fee, these fees were then “Transferred / repackaged” to brokers and called a “Clawback Fee”

The government has already tagged the fee as “unconscionable”, yet allows the banks to continue to charge the fee under another name to small businesses? ASIC is the regulator for the industry, but did/ does not consider this “Clawback of income” unconscionable? (more on this later..)

During that period, lenders made claims that mortgage brokers engaged in client churning, whereby clients were frequently moved from one bank to another, solely to inflate the brokers' commissions per client. This narrative was employed by major financial institutions as a rationale for shifting the financial loss resulting from the Deferred Establishment Fee (DEF) from consumers to the broker industry in the form of a clawback. While it is true that a minority of unethical mortgage brokers did engage in client churning, algorithms existed and continue to exist that can identify these brokers and take appropriate disciplinary action against them. Implementing such measures would result in penalizing only the few brokers involved, rather than all 16,000 brokers. Ironically, the DEF and the Clawback fee can be seen as essentially one and the same. Also, why did the banks NOT take action before the DEF was removed to implement clawbacks if they saw churning as a problem? It appears only to be a "knee-jerk" reaction to losing profit from DEF's to prop up profits lost due to legislation.

During that time, it was deemed acceptable for large businesses to exploit small businesses due to the lack of sufficient legislative safeguards in place. This assumption was based on the belief that small business owners possessed the requisite knowledge and capability to navigate such situations independently. However, the reality is that small businesses are ill-equipped to confront the power dynamics inherent in dealings with large corporations and institutions.

Best Interest Duty (BID) Legislation

Around 2021, the best interest duty was implemented by the government. The best interest duty and related obligations are designed to ensure that retail clients receive advice that meets their objectives, financial situation and needs, and that you act in the best interests of your clients when providing advice. The implementation of this legislation removes any suggestion of brokers churning clients and effectively removes any argument a bank or lender might have to blame brokers for any “Loss”, triggering the said clawback fee. However, the clawback fee remains. Why?

In recent times, financial institutions such as banks and lenders have been providing consumers with enticing incentives ranging from $2,000 to $10,000 in order to encourage loan refinancing. This has prompted a significant number of individuals to refinance their loans, capitalizing on the monetary benefits offered. However, a consequential outcome of this practice, particularly advantageous for the banks and lenders, is the activation of clawbacks on brokers' commissions. Consequently, by actively promoting and initiating the refinancing process, banks and lenders are exacerbating the issue of clawbacks for brokers.

Industry Commentary on clawbacks.

Below are some industry perspectives regarding the clawback problem. However, it appears that individuals within the broker industry feel constrained and powerless to address the issue, as the banks wield considerable influence and possess means to suppress any opposition to the elimination of clawbacks.

“Clawbacks are at odds with the best interest’s duty and are no longer relevant for the broker industry, says aggregator group Finsure.” Finsure CEO Simon Bednar said clawbacks were now unjustified when coupled with exemplary broker conduct and the BID obligations requiring brokers to act in the best interests of their clients. “The protection for lenders against ‘unnecessary churn’ or ‘gaming’ to generate additional commission is the BID legislation,” Bannister said.

Peter White (FBAA) “The average annual clawback value per annum to a broker had surged by 47.4 per cent over three years, from $10,229 in 2018 to $15,077 in 2021.In the same period, lender-causing cashback incentives rose by 59.1 per cent. There was an even higher rise in the number of deals where brokers had to wait 12 months to be paid a commission, due to the net of offset arrangements. The number of deals had more than quadrupled, from 2018 to 2021” “That has a big impact across the industry. When you’re trying to run a business, you’ve done your job and you’re potentially waiting 12 months to get paid for this portion,” he told The Adviser. In December 2021, the article [1] below details the right message from Peter White, but there has been absolutely no real traction to remedy the problem
https://www.mpamag.com/au/mortgage-industry/industry-trends/clawback-banks-are-double-dipping/319431

“Do banks profit from clawback? The assistant Treasurer asks. The assistant Treasurer Stephen Jones MP is interested to see evidence on whether lenders are making money from clawing back broker commissions. (Parliament make this statement but have done nothing to my knowledge to ascertain said figures! -Smoke and mirrors!)

As cashback incentives see clients switching banks, brokers are fed up with fronting the clawback costs. Finance Broker comments (in the Advisor Nov 2022, By Kate Aubrey):
Broker Donna-Marie Colgan at DMC Capital said it was an “extremely challenging environment” right now for brokers.

“I can write a loan for a client and then within six months I am being asked to refinance the loan due to the client hearing of a significant cash back and/or are seeing rates advertised far lower,” Ms Colgan said. “I have no choice but to refinance the loan or I will lose the client (and get the clawback anyway).“I am basically working for free if this happens within two years and it’s killing me!

“I don’t have a fee for service, I don’t charge my clients whatsoever — and I don’t know of another business where it would be OK (in anyone’s eyes) to operate under a business model where … if the client decides to sell or refinance within two years, you have to give every cent you earned back.”

Ms Colgan explained the seven consecutive rate rises had resulted in “panicked clients” looking to switch. “I am a free resource if I don’t change my own model. Lucky I love what I do!” Ms Colgan said.

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While broker Peter Tersteeg at Sage Lending can “appreciate the various reasons lenders have clawbacks”, he added banks lose their agency by offering cashbacks.
“The rule is simple. A lender offering cashback incentives to borrowers of any kind forgoes the right to charge clawbacks to brokers,” Mr Tersteeg said.

“Clawbacks were created to discourage churn by brokers. At the same time lenders are offering cashback offers which encourage churn — the two are contradictory. “There’s even a reasonable argument that brokers’ clawback is covering much of the cost of the cashback.”
While lenders make the argument that cashback offers cover the cost of refinancing, he argued refinancing usually costs about $700–$1,000, while cashback offers range between $2,000–$6,000.

“Lenders have obviously done the research to know that borrower apathy on expensive loans will outweigh the costs of the cashback offer overall,” Mr Tersteeg said.

Atelier Wealth director Aaron-Christie David agreed, stating: “Brokers have long been calling for a level playing field when it comes to cashbacks and clawbacks.

“The consistent feedback from lenders is that clawbacks are a disincentive to churn clients as the bank doesn’t gain an “economic value” until years three or four of a broker-introduced loan. Yet we have numerous lenders offering cashbacks up to $4,000 that have zero strings attached.
“I personally struggle to comprehend that a client is earning more from a cashback than the broker is paid for example on a $300,000 loan without any clauses,” the Sydney-based broker told The Adviser.

Zippy Financial director and principal broker Louisa Sanghera said an increasing number of borrowers were actively refinancing every three to six months just to qualify for cashback payments of thousands of dollars from lenders. “Unfortunately, for some borrowers, the offer of supposedly ‘free’ money via cashbacks has resulted in them sometimes signing up to loans that are not the best fit for purpose over the life of their property loan,” she said. The crux of the problem with cashbacks, is that borrowers may become ‘serial cashback chasers’, resulting not only in brokers facing clawbacks, but also potentially working the same deal repeatedly in a short space time for no extra remuneration.

Bernard Desmond from BLANK Financial said “Cashbacks and clawbacks need to stop,”
“Banks need to reward existing clients for their loyalty rather than buying business by throwing cashback and recovering that from brokers in clawbacks.”

According to Ms Sanghera, the issue is being exacerbated by online cashback groups in which borrowers are “swapping hints and tips on how to secure new cashback deals every few months by using and abusing the services of mortgage brokers”. We are just being inundated with clawbacks because of these hordes of cashback shoppers,” Ms Sanghera continued.

Rules of Law and inequities of applications.

Let us examine these comparable scenarios:

a) Suppose a real estate agent facilitates a property sale to a buyer and unforeseen issues arise within a year, such as the need to replace the septic tank or the discovery of significant foundational problems beneath the dwelling. Would it be legally justifiable to demand that the real estate agent forfeit the entire commission earned from that transaction to address the problem? No.

b) Consider a situation where a Financial Planner invests resources to acquire a new client, conducts thorough due diligence on the client's financial position in accordance with regulatory requirements, and dedicates extensive hours to develop a tailored plan aimed at maximizing the client's future earnings and retirement savings. If the client subsequently seeks advice from a different financial planner or seeks informal guidance from a friend at a social gathering, leading to the termination of the engagement with the original Financial Planner and a request for a refund of the commission paid, is the Financial Planner obligated to reimburse the funds? No.

c) An enterprise enters into a contract with an insurance company, wherein the contract contains a clause that is unfair to the business owner. If the matter is challenged in court, will the insurance provider prevail based on the inclusion of standard form contracts? No. (Further details provided below)

d) A bank or lender establishes an agreement with a finance broker to secure clients. The broker incurs expenses ranging from $150 to $400 for marketing activities and relationship-building endeavours to attract clients. Additionally, the broker invests approximately 20 hours of work, along with associated costs such as phone calls, transportation, and other related expenses, to assist clients in completing loan applications, ensure compliance with relevant legislation, assess the loan's suitability (Best Interest Duty), and evaluate affordability. The broker further uploads the completed applications into the bank's or lender's portal and diligently follows up until the loan is finalized. Moreover, the broker may even extend a personal gift to the client, using their own funds, to commemorate a successful outcome. All these professional services are rendered by the broker with the expectation of receiving a standard commission. However, is it legally permissible for the bank or lender to demand the full return of the earned commission if the consumer sells or refinances the property within 12 months, or 50% of the commission if such an event occurs within two years? Yes!?

Legalities.

The ongoing discourse concerning the management or elimination of clawback clauses in service agreements/contracts within the finance broker industry is a matter of considerable concern. As an experienced finance broker, I find the entire situation profoundly disheartening, as it not only violates the law but also lacks credibility from those advocating for the retention of clawbacks. In my view, industry associations such as the Mortgage and Finance Association of Australia (MFAA) and the Finance Brokers Association of Australia (FBAA) have proven ineffective in addressing this pervasive and systemic issue. This sentiment is widely echoed within the industry. One potential way to assess the true value of these associations would be to make their services optional rather than mandatory for membership. Despite their provision of tools, mentorship programs, and industry awards, it is disconcerting that they have failed to collectively resolve this problem over the years. The MFAA & FBAA should have rallied the brokers and done what they are paid to do; advocate for the brokers interests. Clawbacks kill broker businesses!

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Within the context of promoting sensitivity and inclusivity, it is the writer's perspective that both the MFAA and FBAA exhibit a notable lack of assertiveness and efficacy in addressing this systemic issue. It appears they are hesitant to take actions that may potentially disrupt the interests of banks, lenders, their stakeholders, or jeopardize their sponsorships, overall viability, and integrity. Consequently, they have failed to adequately confront the pressing issue that is causing financial hardship for brokers. Regrettably, aggregators also find themselves constrained when it comes to addressing this matter, as they face similar liabilities as brokers and must also consider the well-being of their affiliated brokers in various respects.

An example highlighting how industry representatives handle the clawback issue is noteworthy. When I recently inquired with one of the industry associations about their efforts to combat this problem, the response was simply that they were engaged in negotiations with banks and members of Parliament to ascertain the precise extent of the loss compared to the charged clawback, with the intention of potentially negotiating a "reduced" amount for the clawback. However, months have passed, and I am still awaiting progress. The puzzling aspect is why we, as an industry, are merely "requesting" that banks devise a solution to a problem they have no desire to resolve. It is imperative that we seek external avenues (such as ASIC or legal channels) to address this issue, as the banks will not willingly relinquish such a lucrative source of income.

https://www.mpamag.com/au/mortgage-industry/industry-trends/clawback-banks-are-double-dipping/319431

Based on recent data obtained, I estimate that brokers are enduring a staggering $24,123,200 in clawbacks each month. This equates to an annual sum of $289,478,400, calculated on the basis of approximately 19,200 brokers, in clawbacks each month.

Who do we approach about this “Clawback” problem?

Australian Financial Complaints Authority (AFCA) - stance on Clawbacks.
While the clawback issue appears to be a genuine systemic problem within the industry, it becomes essential to identify the appropriate channel for lodging complaints. Initially, we turned to AFCA (Australian Financial Complaints Authority), as their name suggests they handle complaints within the finance industry.

We submitted an actual complaint to AFCA regarding a clawback situation where the bank bore responsibility for the client's departure shortly after the loan was initiated. The client's decision to leave was primarily driven by poor service and frustration in dealing with the bank, as explicitly stated in an email provided by the client. Our intention was to present this evidence to the bank to prevent the clawback. However, the bank refused to acknowledge any liability and proceeded with the clawback.

AFCA's ruling on their refusal to consider a complaint about "Clawbacks" was as follows:
“Section B.2 of our rules outline the relationships giving rise to a complaint that AFCA can consider. According to AFCA, rule B.2.1(a) a complaint must arise from or relate to the provision of a financial service by the financial firm to the complainant.

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Consequently, we sought clarification from AFCA regarding the definition of "Service," considering that the lender provided services to our organization while we reciprocated by offering our services to them. We highlighted that the lender provided our firm with services such as access to Business Development Managers (BDMs) for support, educational webinars, professional development opportunities, product-related resources, and access to their online portal for submitting applications and associated documentation. Additionally, we emphasized that brokers entered into agreements with the lender to gain access to their products and software.
AFCA's response was as follows:

"The term "financial service" is defined in section E of our rules. A financial service is provided when for example, a financial firm provides financial or investment advice to it's customer, provides its customer with a financial product, or authorises a transaction on its customers account."
Based on this explanation, AFCA declined to proceed with the complaint related to the clawback and closed the file.

Initially, the bank's solicitor attempted to dismiss the complaint by stating that they had no agreement with the broker and that their agreement was solely with the aggregator. However, we were able to demonstrate that this assertion was not entirely accurate, as there exists a signed agreement between the bank and the broker for selling the bank's products, along with accreditation requirements. Additionally, it can be substantiated that the broker acts as a representative of the bank, with client files serving as evidence of this relationship. It can also be noted that the bank/Lender makes payments to the Broker via the aggregator for work done, otherwise, how would the aggregator know who to pay when they receive funds.

The Productivity Commission Report

In the 2023 report, the PC touches on competition in business lending and broker remuneration but only makes a particular recommendation on the former.

PC calls on government to monitor SME finance, flags broker remuneration. Government should monitor APRA and ABSF's activities to ascertain "whether they are having the desired impacts on SME lending", the Productivity Commission has said. Broker commission and clawback structure revisited.

While the PC inquiry does not put forward any particular recommendations around mortgage broking, the report does mention its issue of broker remuneration in passing.
The PC rehashed some of its findings from its 2018 review of broker remuneration when discussing competition in the home loan market.

The inquiry report read: "In some cases, regulation has yet to catch up with developments that reduce the benefits of competition for consumers. For example, incentive structures for brokers in the home loan market, which include trail commissions and 'clawback' of commissions, create conflicting incentives ...

"These structures — with their associated reduced benefits of competition for consumers — remain in place, following the abandonment of a slated ACCC review."
Despite this mention, the PC has not made any recommendations to the government on changing broker remuneration.

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There are other Government departments that are sitting on the outskirts and not game to "Poke the bear". The ACCC 's job is to protect competition in the market. The ACCC state that it is OK to under cut competition to gain market share and market effectively to kill off the small corner deli's and so on, but they do not mention anything about theft of competition's income? I really do not understand how ASIC and ACCC can't make the correlation between the "unconscionable" act of charging money to consumers for closing a loan early (DEF) and the "Unconscionable" act to apply a clawback to brokers for the same reason. Both parties really, are one and the same!

What the ACCC does

We protect and promote competition in markets to benefit consumers, businesses and the community.
We provide general information about businesses' obligations under competition law.
We investigate anti-competitive business behaviour that may be illegal.
We enforce the law on anti-competitive behaviour and take action against businesses that break the law

- .We investigate cases of potential misuse of market power.
- We enforce the law on misuse of market power and take court action against businesses that break the law.

.**What the ACCC can't do**

- We don't intervene directly in disputes between businesses.
- We don't give legal advice.

Practices that may be misuse of market power
It's illegal for businesses with substantial market power to do anything with the purpose, effect or likely effect of substantially lessening competition.

Businesses with substantial market power must not do something which stops other businesses from competing on their merits. The law doesn't label specific practices as a misuse of market power.
However, there are practices that can sometimes be a misuse of market power. Whether any particular example of these practices is a misuse of market power depends on the specific circumstances. (Clawbacks can definitely fall within the realm of misuse of power and lessening competition by forcing brokerages to suffer and close from financial loss.)

APRA is Australia's prudential supervisor, responsible for ensuring that our financial system is stable, competitive and efficient.

The Australian Prudential Regulation Authority (APRA) is an independent statutory authority that supervises institutions across banking, insurance and superannuation, and is accountable to the Australian Parliament. APRA was established by the Australian Government on 1 July 1998 following the recommendations of the Wallis Inquiry into the Australian financial system. Prudential regulation is concerned with maintaining the safety and soundness of financial institutions, so that the community can have confidence that they will meet their financial commitments under all reasonable circumstances.

APRA is tasked with protecting the interests of depositors, policyholders and superannuation fund members. Our purpose is to ensure Australians' financial interests are protected and that the financial system is stable, competitive and efficient.

While the ACCC has also dropped the ball (as clawbacks are damaging the broker industry) we do not think the clawback issue falls within their scope of action. APRA is more for consumers.

Some Lenders do not have a Clawback Clause!

Lenders can choose to remove (not charge) clawbacks, (see below examples) however, most choose to take advantage of brokers.

Mortgage Ezy has removed clawbacks on loans through its lending program, a move it says represents its leadership on a longstanding issue affecting brokers. Peter James founder of non-bank lender and mortgage manager Mortgage Ezy, told MPA that if a loan was refinanced within two years of the commencement date, the business had taken the view that this was simply “a cost of doing business”. James said that over the last couple of years, a number of banks had thrown money at borrowers in the form of cashback offers. In November those offers reached as high as $6,000 and $10,000. These cashback offers give borrowers an upfront cash incentive to refinance to another bank, which may not be in their best interests.

“Bednar (CEO of Finsure Group) said clawbacks had been around for just over a decade when the federal government banned lender exit fees which charged the borrower for exiting the loan within two years. The lenders simply renamed the fee and now charge the broker instead,” he said.

“La Trobe Financial chief lending officer and senior vice-president Cory Bannister is supportive of Bednar’s comments. The non-bank lender does not have a clawback policy.”

Islamic finance provider Hejaz Financial Services has announced it is abolishing all clawbacks on Hejaz home lending products effective immediately. The announcement coincides with Hejaz recruiting its 1,000th accredited mortgage broker to its network, which the company considers an important milestone as it strives to make Sharia-compliant home loans accessible to Australian Muslims.

The Rule of LAW

There are two legal principles that lead us to believe that the clawback of a finance broker's commission is in violation of the law.

a) We contend that the inclusion of the clawback clause in ***standard form contracts*** may infringe upon Australian law concerning such contracts.

b) The ***principle of quantum meruit*** establishes that individuals should be remunerated for the work they perform. Consequently, it is imperative that finance brokers receive compensation for the services rendered, regardless of whether the loan facility is closed within the 12 to 24-month period stipulated or irrespective of the presence of a clawback clause within the agreement.

A Standard Form Contract

A standard form contract, under Australian Law, is a pre-drafted agreement that typically favours one party. It contains non-negotiable terms and conditions, often used in commercial transactions, where the other party has limited or no ability to negotiate or modify the contract terms. These contracts are commonly found in industries such as telecommunications, insurance, banking, and utilities. The imbalance of bargaining power between the parties can raise concerns about fairness and the protection of rights. The law recognizes the need for transparency and fairness in such contracts and provides legal safeguards to address any potential exploitation or unfairness.

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A bank or lender initially establishes a standard form contract with a predetermined commission structure, which is payable to finance brokers. This contract also incorporates a clawback clause.

Essentially, the standard form contract outlines the responsibilities of the finance broker, including procuring clients for the bank, familiarizing themselves with the bank's products and guidelines, acting as the bank's representative, collecting and submitting all necessary documentation through the bank's portal for evaluation, and assisting in the loan settlement process. In return for these services, the broker is entitled to receive a commission, which covers approximately 20 hours of work and associated expenses incurred in acquiring the client.

However, the contract also includes a clawback clause, enabling the bank to recover all commission payments if the client closes the loan facility within 12 months of its inception, and 50% of the commission within 24 months. We contend that this clawback clause is in violation of "standard form contracts" under Australian law. The presence of this clause raises concerns as it essentially implies that finance brokers may end up working without compensation.

In Australia, a finance broker who has had their commission clawed back may argue that the standard form contract is "unfair" and thus voidable. As per the Australian Consumer Law, a standard form contract is considered "unfair" if it:

- Creates a significant imbalance in the rights and obligations of the parties involved.
- Is not reasonably necessary to protect the legitimate interests of the party benefitting from it.
- Causes detriment to the disadvantaged party when applied or relied upon.

In this case, the finance broker may assert that the clawback clause within the standard form contract results in a significant imbalance in rights and obligations, as it grants the bank the unilateral authority to reclaim commission without adequate justification. Furthermore, the clause is not reasonably necessary to safeguard the bank's legitimate interests, given that the broker has already performed the services for which the commission was paid.

The broker may also argue that the clawback clause leads to financial detriment for them, as their livelihood depends on commission income, and they have already incurred expenses while providing the services that warranted the commission. Consequently, the clawback clause violates the laws governing standard form contracts and should be rendered null and void.

In addition to the unfair contract argument, the broker may contend that the bank acted unconscionably by exercising the clawback clause despite being aware or reasonably expected to know that it would cause financial harm to the broker. This argument can be supported by presenting evidence of the broker's financial situation and demonstrating the bank's awareness of it.

Principle of quantum meruit

Additionally, there is an entirely different rule of law called the principal of Quantum Meruit. In Australian law, the principle of quantum meruit generally applies in situations where there is no express contract or when a contract is found to be unenforceable. Quantum meruit allows for a reasonable payment to be made to a party who has provided goods or services without a pre-existing agreement regarding payment.

While quantum meruit is often associated with situations where there is no contract in place, it is important to note that it can also be invoked in cases where a contract exists but is found to be unenforceable due to factors such as illegality, uncertainty, or a lack of essential terms. In such instances, the principle of quantum meruit enables the court to assess the fair and reasonable value of the goods or services provided by one party to another, even in the absence of a valid contract.

Furthermore, even when a contract is in place, but the contract is silent or ambiguous on the issue of payment, quantum meruit may be invoked to determine a reasonable amount of compensation based on the value of the goods or services provided.

The principle of quantum meruit allows for a fair and reasonable payment to be made to a party who has provided valuable goods or services, ensuring that they are not unjustly deprived of compensation.

In Australian law, the principle of quantum meruit holds significant importance in contractual relationships where parties provide goods or services without a pre-existing agreement regarding payment. Quantum meruit, which translates to "as much as is deserved," allows for a reasonable payment to be made to a party who has provided valuable goods or services, based on the fair value of their contribution. This article will provide a professional and legal analysis of the principle of quantum meruit, its definition, and two notable examples of its application in Australian jurisprudence.

The principle of quantum meruit can be invoked in various situations, including:
Implied Contracts: In some cases, parties may engage in a course of conduct that implies an agreement for goods or services, even without a formal contract. When the implied contract fails to specify the payment terms, the principle of quantum meruit can be applied to determine a reasonable amount to be paid. This prevents unjust enrichment of one party at the expense of the other.

Partial Performance: Quantum meruit can also be invoked when a contract is partially performed or terminated before completion. If a party has already provided goods or services but is unable to complete the contract due to unforeseen circumstances or the other party's breach, they may be entitled to payment for the work completed up to that point. The principle of quantum meruit ensures that the party is compensated fairly for the value of their partial performance.
Examples of Quantum Meruit in Australian Law

Construction Industry: In the construction industry, the principle of quantum meruit has been applied in cases where there is no formal contract or where the contract lacks clear provisions regarding payment. For example, if a builder completes substantial work on a project based on an informal agreement but is not paid due to a dispute over the contract's terms, the builder may seek payment on a quantum meruit basis. The court would assess the reasonable value of the builder's work and order payment accordingly.

Continued...

Professional Services: Quantum meruit has also been invoked in cases involving professional services, such as legal or accounting services. If a professional provides advice or services to a client without a written agreement specifying the fees, they can rely on the principle of quantum meruit to claim a reasonable payment for their services rendered. The court would consider factors such as the nature of the services, market rates, and the value of the professional's contribution to determine fair compensation.

You must remember that the Principle of Quantum Meruit can also be applied irrespective of a contract in place with compensation being unsatisfactory.(taking in all factors of the situation)

Australian Consumer Law (ACL)

The Australian Consumer Law (ACL) also applies to businesses like finance brokers when they enter into standard form contracts with banks or lenders. The ACL's unfair contract terms regime aims to safeguard small businesses against unfair terms in such contracts. It is important to note that the ACL does not explicitly define what constitutes a standard form contract, but it is generally understood as a contract prepared by one party without negotiation between the parties involved.

In the context of finance brokers, there may be potential arguments based on the Standard Form Contract Law that can be employed to address clawbacks. For instance, it could be asserted that the clawback clause creates a significant imbalance in the rights and obligations of the parties and causes financial harm to the broker. The broker could also contend that the bank acted unconscionably in implementing the clawback clause.

Under the "unfair contract terms" law, standard form consumer contracts for financial products or the provision of financial services are covered [1]. The broker could argue that the clawback clause results in a significant imbalance in rights and obligations, is not reasonably necessary to protect the bank's legitimate interests, and causes financial detriment to the broker [1]. If a term in a contract is deemed unfair, ASIC has the authority to take enforcement action against the business, rendering the term void and unenforceable [1]. Additionally, individuals have the option to apply to a court to have an unfair term in a standard form contract declared void [2].

[1] Source: Australian Competition and Consumer Commission (ACCC) - Contracts and agreements: https://www.accc.gov.au/consumers/buying-products-and-services/contracts

[2] Source: Australian Securities and Investments Commission (ASIC) - Unfair contract term protections for small businesses: https://asic.gov.au/about-asic/what-we-do/our-role/laws-we-administer/unfair-contract-terms-law/unfair-contract-term-protections-for-small-businesses/

Here are recommendations on what a small business (or beneficiary) can do if they want to challenge a term of their contract:

Step 1: Complain to the financial services provider

First, they can make a complaint to the financial services provider they have the contract with to try to get the result they want. They can also seek assistance from the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), which provides dispute resolution support.

Continued....

Step 2: Complain to the Australian Financial Complaints Authority

If the financial services provider cannot resolve the complaint, they may be able to complain to the Australian Financial Complaints Authority (AFCA). AFCA provides consumers and small businesses with a free and independent dispute resolution scheme to assist with resolving financial complaints.

Step 3: Apply for a court to declare the term unfair

Depending on the result of the complaint to AFCA, they can apply to a court for a declaration that the term is unfair. If they are successful, the term will be void.

Unfair contract term protections for small businesses (other than finance businesses) As addressed by ASIC

ASIC has addressed “Unfair” contract terms within other industries and identified (in other industries) that sub-contractors need to be paid for the work they do.
In November 2016, the Australian Consumer Law was extended to protect small businesses from unfair contract terms. The unfair contract terms protections apply to insurance contracts from 5th April 2021.

The information sheet (INFO 211) explains how the law protects small businesses from unfair terms in contracts ***for financial products and services.***

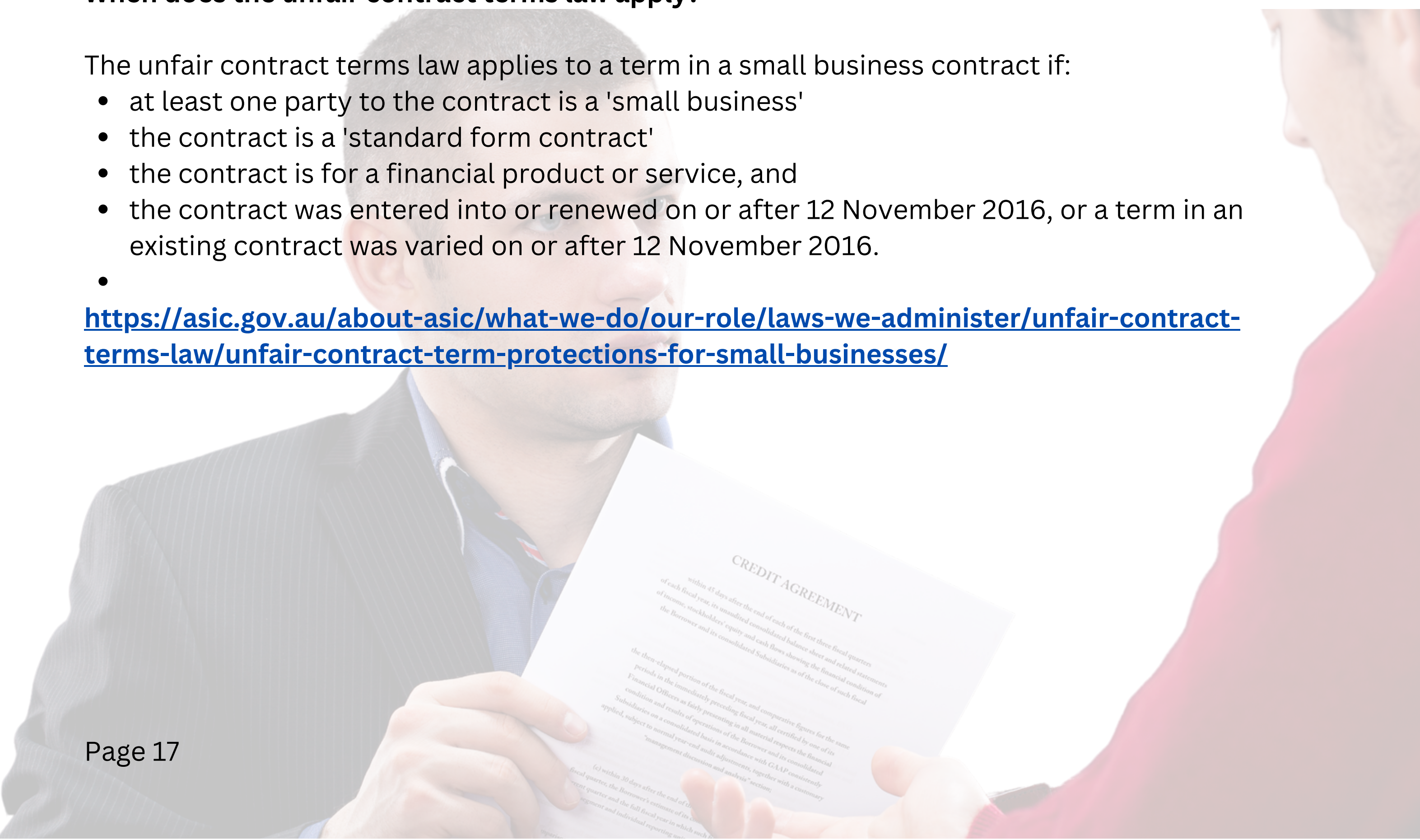
It describes how small businesses can challenge a term under the unfair contract terms law in the Australian Securities and Investments Commission Act 2001 (ASIC Act), what happens if a term is unfair, and what ASIC can do.

When does the unfair contract terms law apply?

The unfair contract terms law applies to a term in a small business contract if:

- at least one party to the contract is a 'small business'
- the contract is a 'standard form contract'
- the contract is for a financial product or service, and
- the contract was entered into or renewed on or after 12 November 2016, or a term in an existing contract was varied on or after 12 November 2016.
-

https://asic.gov.au/about-asic/what-we-do/our-role/laws-we-administer/unfair-contract-terms-law/unfair-contract-term-protections-for-small-businesses/



Additional Information and explanations of Standard Form Contract Law

The law applies to standard form contracts entered into or renewed on or after 12 November 2016, where:

1. Unfair terms in standard form contracts

Sometimes, a buyer and seller work out terms together before they agree to a contract. But often, a business will use a pre-written contract for all their customers that the customer can't change, they can only take it or leave it. This is called a standard form contract.
There is a presumption that a contract is a standard form contract, so the party that prepared the contract has to prove that it isn't.

In deciding what a standard form contract is, a court will consider whether:

- the party that prepared the contract has all or most of the bargaining power in the transaction.
- the contract was prepared without or before any discussion between the parties about the transaction.
- the other party could only either accept or reject the terms of the contract as presented.
- the other party was given any real opportunity to discuss the terms of the contract.
- the terms of the contract consider any specific features of the other party or the transaction.

2.Determining whether a term is unfair.

Laws protect consumers and small businesses from unfair terms in standard form contracts. Contract terms are unfair if they:

- give one party a significant advantage over the other.
- are not necessary to protect the legitimate interests of the party with the advantage, and
- would cause financial or other harm to the other party if enforced.

Only courts can make final decisions about whether a contract term is unfair.

In deciding whether a term is unfair, the court will consider all the rights and responsibilities for each party under the contract, as well as whether the term is transparent. A term is transparent if it is in reasonably plain language, clear, and not hidden.

The court will consider whether any other terms in a contract offset the potential unfairness of a term.

Example of an unfair contract term

1.Business "A" provides 3 year contracts for broadband services. A term of Business A's contract allows it to change the price for the services at any time during the 3 years. The customer is not allowed to end the contract, even if they don't agree to the price increase.

2.Business B provides 3 year contracts for broadband services. A term of Business B's contract allows it to change the price for the services at any time during the 3 years. However, another term of Business B's contract allows customers who don't agree to a price increase to end the contract without any penalty.

The term that allows Business A to change prices during the contract term is likely to be an unfair contract term. However, the similar term in Business B's contract is likely to not be an unfair contract term because the other term balances it.

The unfair contract terms law does not apply to:

- terms that are specifically required or permitted by another law
- terms that set out the price to be paid
- terms that define the product or service being supplied under the contract
- company constitutions
- commercial contracts for the shipping of goods by sea.

For small businesses

Small businesses are protected from unfair terms in standard form contracts for products, services or land transactions if:

- they have 20 or fewer employees
- the upfront price payable is under $300,000, or $1 million for contracts lasting more than 12 months.

Employees are counted by:

- considering the number at the time the contract is agreed.
- including any casual employees if they are employed on a regular and systemic basis not including the employees of any related business entities.

Businesses using standard form contracts should make enquiries to work out whether their customers will fall under these thresholds. If in doubt, it may be safest for the business to assume their customers will.

The upfront price payable includes any payments for the product or service being supplied under the contract, which are disclosed when the contract is agreed. This includes any payments that are required if certain things happen under the contract. However, it does not include any amounts that can't be worked out at the time the contract is agreed.

Continued...

A change to the law will come into effect on 10th November 2023 that will replace the above thresholds. Small businesses will be covered by the unfair contract terms protections for any new or varied standard form contract from that date if they:

- have 100 or fewer employees, or
- make less than $10 million in annual turnover.
- Financial products and services

For information about unfair terms in contracts for financial products and services, such as loans and financial advice, contact ASIC, which regulates these types of contracts.

Unfair Business Practices

Unfair trade practices include false representation of a good or service, targeting vulnerable populations, false advertising, tied selling, false free prize or gift offers, false or deceptive pricing, and non-compliance with manufacturing standards. Alternative names for unfair trade practices are "deceptive trade practices" or "unfair business practices."
https://www.maddocks.com.au/insights/grappling-b2b-unfair-contract-term-laws

When is a TERM unfair?

A term of a contract is unfair if:

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract
- it is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term (there is a rebuttable presumption against this)
- it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

In determining fairness, the court must take into account the extent to which the term is transparent (i.e. in plain English, legible, clear and readily available) and the contract as a whole. Examples of unfair terms are as follows: a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract term that permits, or has the effect of permitting, one party to vary the upfront price payable under the contract without the right of another party to terminate the contract. For example:

- a term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied, under the contract a term that permits, or has the effect of permitting, one party unilaterally to determine whether the contract has been breached or to interpret its meaning.
- a term that limits, or has the effect of limiting, one party's vicarious liability for its agents.
- a term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent.

Continued...·

- a term that permits, or has the effect of permitting, one party (but not another party) to:
    - avoid or limit performance of the contract
    - terminate the contract
    - vary the terms of the contract
    - renew or not renew the contract.

When does the unfair contract terms law apply?

The unfair contract terms law applies to a term in a small business contract if:

- at least one party to the contract is a 'small business'
- the contract is a 'standard form contract'.
- the contract is for a financial product or service, and
- the contract was entered into or renewed on or after 12 November 2016, or a term in an existing contract was varied on or after 12 November 2016.

Small business contract

A contract is a small business contract if:

- at least one party to the contract is a 'small business' – that is, a business that employs fewer than 20 people at the time the contract is signed (including casual employees employed on a regular or systematic basis), and
- the upfront price payable under the contract does not exceed $300,000 (or, if the contract is for more than 12 months, $1 million) (the 'cap').

Standard form contract

- The unfair contract terms law covers standard form small business contracts for financial products or the supply, or possible supply, of financial services.
- A 'standard form contract' is a contract that has been prepared by one party to the contract (the business offering the product or service) without negotiation between the parties. In other words, it is offered on a 'take it or leave it' basis.
- ***the financial services sector is regulated by the Australian Securities and Investments Commission (ASIC), which has developed guidelines to ensure the fairness and transparency of standard form contracts in this industry.***

(NOTE: If ASIC are responsible for ensuring fairness for the standard form contracts in the finance/broker example,- why was the Broker clawback clause ignored?)

Small businesses commonly enter into standard form contracts for financial products and services such as contracts for business loans, credit cards, insurance cover or **broker agreements.**

Continued...

If a small business alleges that a contract is a standard form contract, the contract is presumed to be a standard form contract unless proven otherwise.
In determining whether a contract is a standard form contract, a court may take into account any relevant matter, but must consider whether:

- the business offering the product or service has all or most of the bargaining power relating to the transaction
- the contract was prepared by the business before any discussion with the small business about the transaction
- the small business was in effect required to either accept or reject the contract as it was offered (i.e. on a 'take it or leave it' basis)
- the small business was given an effective opportunity to negotiate the terms of the contract, and
- the terms of the contract take into account the specific characteristics of the small business or the particular transaction.

Protocol dictates to submit a Complaint to AFCA after speaking with the bank.

- Step 1: Complain to the Australian Financial Complaints Authority
- If the financial services provider cannot resolve the complaint, they may be able to complain to the Australian Financial Complaints Authority (AFCA). AFCA provides consumers and small businesses with a free and independent dispute resolution scheme to assist with resolving financial complaints.
- Step 2: Apply for a court to declare the term unfair
- Depending on the result of the complaint to AFCA, they can apply to a court for a declaration that the term is unfair. If they are successful, the term will be void.
- What ASIC can do about unfair contract terms
- To make a complaint to ASIC about an unfair contract term, a small business can lodge a report of misconduct online: see Information Sheet 153 How ASIC deals with reports of misconduct (INFO 153).
- ASIC do not generally take action for a small business unless it is in the wider public interest, and ASIC can only take action if the matter is within their area of responsibility.
- ASIC cannot endorse contract terms or declare that they are unfair. Only a court can decide whether or not a term is unfair.
-

https://www.accc.gov.au/business/selling-products-and-services/contracts

A term of a standard form contract will be "unfair" if it is one-sided and excessive, that is, it creates a "significant imbalance" between the parties 1, is not reasonably necessary to protect the benefiting party's legitimate interests 2 and would cause detriment to the other party.

In determining whether terms are "unfair", a court will also read the term(s) in the context of the entire contract and will take into consideration the transparency of the contract, including how upfront, easy to read and clearly presented the contract is to the affected party.

Examples of terms that may be unfair include terms that allow one party to unilaterally change key elements of a contract, and terms that limit one party’s rights. More examples have been given by the Parliament (in s 25 of the ACL), the ACCC and courts.

Continued...

It is not yet unlawful to include an unfair term in a contract and there are no pecuniary penalties for doing so yet. However, penalties are coming in approximately late-2023. A Bill passed the Australian Parliament on 27 October 2022.

Remedies include injunctions, compensation orders and non-party redress orders, such as declaring part of a contract void, varying a contract and ordering refunds. However, disqualification orders, community service orders and infringement notices do not apply to unfair contract terms.

NEW LAWS: Unfair contract terms penalties commence in November 2023

Commencing in November 2023, penalties can be imposed for using and relying on unfair contract terms. Unfair contract term laws will also be extended to cover more contracts from that time.

The Treasury Laws Amendment (More Competition, Better Prices) Act 2022 (Cth) (the amending Act) received assent on 9 November 2022. The unfair contract term changes in Sch 2 commence one year

CCH Pinpoint subscription required - Log in »

https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6923

Businesses now have less than 12 months to cease using unfair contract terms in their standard form consumer contracts and small business contracts, now that the Treasury Laws Amendment (More Competition, Better Prices) Act 2022 has received the Royal Assent.

Whereas unfair contract terms can presently be rendered void and unenforceable, the use of unfair contract terms in standard form contracts made or varied from 9th November 2023, will expose users of those contracts to potentially significant penalties, as foreshadowed in our earlier *Legal Insight*.

Businesses should prioritise within this period a review of all standard form contracts that they use with either consumers or small businesses, conscious also of the expanded definition of 'small business contract'. It is also a timely opportunity for businesses who supply consumers in New South Wales to review their terms and conditions for compliance with their additional disclosure obligations.

Unfair contract terms to be rendered illegal.

What is a standard form contract?

The Australian Consumer Law (ACL) does not expressly define what a 'standard form contract' is. However, the court's default presumption will be that a contract is a 'standard form contract'. The burden will be on, in effect, the party proposing the contract to prove otherwise.

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The ACL does set out a number of factors that a court is obliged to consider. Notably, the Amending Act now goes further to confirm that a contract can be regarded as a ‘standard form contract’ despite the opportunity for:

- a party to negotiate minor changes to the contract;
- a party to select a term from a range of options provided; or
- a party to another contract or proposed contract to negotiate terms of the other contract or proposed contract.

What is a ‘consumer contract’?

A ‘consumer contract’ is a standard form contract for a supply of goods or services, or a sale or grant of an interest in land, to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.
The definition of a ‘consumer contract’ is reasonably well understood, and will not be changed by the Amending Act.

What is a ‘small business contract’?

The concept of a ‘small business contract’ will be changed materially by the Amending Act and will now likely catch many more dealings where a standard form contract is used.
A ‘small business contract’ will exist where the standard form contract is either:

- for a supply of goods or services, or a sale or grant of an interest in land; or
- in the case of financial products and contracts for the supply of financial services, has an upfront price that does not exceed $5,000,000;

and at least any one party to the contract either:

- makes the contract in the course of carrying on business and at a time when the party has fewer than 100 employees; or
- had annual turnover below $10 million.

Are all standard form contracts affected?

The amendments to the unfair contract terms regime will not apply to contracts made before 9 November 2023 – the existing regime will continue to apply, which could still allow unfair contract terms to be rendered void – however any existing contract renewed on or after 9 November 2023 will become subject to the new regime and any amendment made on or after 9 November 2023 will also be subject to the new regime.

For contracts being made on or after 9 November 2023, there will be very limited exceptions to the application of the new regime. It is prudent for businesses using any form of document that has characteristics akin to those described above to be assuming that their document is affected and to take advice accordingly.

What is an unfair contract term?

The concept of a term being ‘unfair’ has not changed – it will be regarded as ‘unfair’ if it has all of the following features:

1. It would cause a significant imbalance in the parties’ rights and obligations arising under the contract.

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2. It is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term.
3. It would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

What terms are excluded from the regime?

A term cannot be regarded as unfair where the term:

- defines the main subject matter of the contract; or
- sets the upfront price payable under the contract; or
- is required, or expressly permitted, by a law of the Commonwealth or of a State or Territory; or
- the term is included in the contract, or is taken to be so included, by operation of such a law that regulates the contract; or
- the term's inclusion has the result of either or both:
  - one or more other terms are included in the contract, or are taken to be so included, by operation of a law of the Commonwealth, or of a State or Territory, that regulates the contract; and/or
  - such a law requires one or more other terms to be included in the contract; or
- in the case of Insurance Contracts Act insurance contract, is a transparent term and:
  - is disclosed at or before the time when the contract is made; and
  - sets an amount of excess or deductible under the contract.

The Amending Act will now provide comfort for those users of standard form contracts where a term is, in effect, deemed or incorporated into the contract because of Australian statute. This will be of relevance to, for example, landlords of retail premises where retail leasing legislation imposes or incorporates provisions in a retail lease.

What are the potential penalties?

For the first time, the use of an 'unfair contract term' can attract civil penalties where pursued by a regulator before the courts. For a body corporate, the maximum penalty will be the greater of:

- $50 million;
- three times the value of the benefit the body corporate (and any related body corporate) obtained from using the unfair contract term; or
- if the court cannot determine the value of that benefit, 30% of the corporate group's 'adjusted turnover' during the 'breach turnover period'.

For a person other than a body corporate, the maximum penalty will be $2.5 million.

See our other recently published Legal Insight for more information on changes to the penalty's regime in competition and consumer law.

Further, a court can make other orders to void, vary or refuse to enforce part, or all, of a contract (or collateral arrangement); make orders that apply to any existing standard form contract (whether or not that contract is put before the court) that contains an unfair contract term that is the same or substantially similar to a term the court has declared to be an unfair contract term; and issue injunctions with respect to existing or future standard form contracts

Continued...

that contain a term that is the same or is substantially the same as a term the court has declared to be an unfair contract term.

What should businesses be doing now?

While an 'unfair contract term' can, at times, be in the eye of the beholder, the potential consequences for getting it wrong could be significant. Businesses should therefore be:

- identifying all contracts they use that have the potential to be regarded as 'standard form contracts', regardless of what they may be named and how they may be presented; and
- having those reviewed for any terms that may be at risk of being an 'unfair contract term', and
- taking steps, where possible, to address that risk.

In Summary:

While it can be argued that the clawback clause is illegal in the Lender/Broker agreement, (under a "Standard Form Contract" or the "Principal of Quantum Meruit") no one has effectively taken banks and lenders to task on this issue. Many assumptions can be made as to why people and organisations are dodging the subject:

- FBAA : while they object to clawbacks, in recent times, they have taken the option of "asking" the banks for the real costs of a loan closure within 2 years, to ascertain what brokers should be paying as a clawback. This falls way short of dealing with the actual problem itself and relies entirely upon the banks and lenders to find a solution, which they will not, as they are happy taking thousands of dollars from brokers.
- MFAA: are silent on the whole subject?
- AFCA: find a technicality within their rules to avoid dealing with clawbacks.
- Legal Class Actions: we have approached 6 high profile legal firms who deal in class actions, all of them have stated that they do not have the capacity to take on this claim / case. Keep in mind, that we only need to take ONE bank to court, win and set a precedent. The rest will fall into line.
- ASIC: We are putting a case together for ASIC now and lodged a formal complaint, although we are mindful that the financial services sector is regulated by the Australian Securities and Investments Commission (ASIC), which has developed guidelines to ensure the fairness and transparency of standard form contracts in this industry. (but NOT enforced them) We are not hopeful that ASIC will take this issue seriously. To date, ASIC seem to be turning a blind eye to this, even with the implementation of BID. However, they will need to look at this more seriously if there are 19,000 brokers behind it.

The MFAA (Mortgage and Finance Association of Australia) and the FBAA (Finance Brokers Association of Australia) should have taken decisive action to address the illegality of clawbacks years ago, in my view.

As the peak bodies and representatives of the entire broker industry in Australia, their responsibility is to advocate for the interests of the 19,000-plus brokers under their membership. They have engaged with politicians, who, unfortunately, have provided nothing more than superficial support without taking substantial action.

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This situation is unacceptable considering the staggering amount of approximately $24,123,200 per month that brokers are losing to clawbacks. Such blatant misappropriation is unprecedented in any other industry. It raises questions about the effectiveness and integrity of these industry bodies. Are there other industry associations that are better equipped to address these critical issues?

It is important to note that my concerns extend beyond my personal losses as a finance broker. I am also voicing the concerns of the 19,000 other small business owners who operate as finance brokers. Collectively, we expect our industry representatives to champion our cause and safeguard our financial well-being.

What can we (You) do?

A formal complaint has been lodged with ASIC, and we are now in the process of waiting for ASIC to review and assess the complaint's validity, which was submitted on June 13, 2023.
There may be additional options to select a bank and legally test the Standard Form Contracts and the Principle of Quantum Meruit. Collaboratively, brokers can find legal representation. Should this be successful, this will set a precedent to flow onto all other banks and lenders. We will also be seeking retrospective damages/refund for claw backed income over the last two years (minimum).

Through various forums, PD days, and discussions, it has become evident that clawbacks are affecting a significant number of brokers. The impact is severe, with many experiencing substantial reductions in income, some even being forced to cease their finance broking operations altogether. Others are facing tremendous challenges in sustaining their businesses.

Not only are brokers facing these adverse consequences, but consumers are also being disadvantaged. Many brokers are reluctant to assist clients who are likely to close their proposed loans within two years or have expressed interest in cash-back offers from banks, as it would trigger the clawback provision. Additionally, existing clients are approaching brokers to switch to banks offering substantial cash-back incentives, requiring brokers to redo the entire loan process without any financial compensation, effectively offsetting an impending clawback.

I have personally witnessed brokers enduring clawbacks of up to $10,000 per month, with one broker losing approximately $17,000 due to the closure of four loans within 2 months. To put this into perspective, considering this broker's annual income of approximately $70,000, nearly a quarter of their yearly earnings was deducted (Clawed back) in just two months.

An FBAA report last year revealed that the average annual clawback value per annum to a broker had risen from $10,229 in 2018 to $15,077 in 2021, being a 47.4% increase. In the same period, lender-causing cashback incentives increased by 59.1%. That was at a time in mid-2021 where only 24 lenders were offering cashbacks between $1,000 and $4,000, according to Rate City.

Continued...

According to industry reports [1], clawbacks accounted for 30% of all commissions paid to mortgage brokers in Australia in 2021. The rise in cashback incentives has resulted in a surge in annual clawback value for brokers, with the average clawback value per annum surging by 47.4% from $10,229 in 2018 to $15,077 in 2021 [1]. This has led to a decrease in income for many small businesses in the industry, with some brokers reporting a reduction in commissions of up to 50% [1]. The Financial Brokers Association of Australia (FBAA) is urging the regulator to overhaul the "unjust" practice of clawback fees, which see brokers lose a percentage of their commission if a client terminates the mortgage within the first two years of the contract [3]. The policy has also affected newly established brokers who are trying to make their way in the industry [1]. While the Mortgage and Finance Association of Australia (MFAA) notes clawback is directly linked to how lenders price their product, ANZ and NAB Broker have redirection practices in place which return customers to the broker where possible to avoid

[1] https://www.theadviser.com.au/broker/43671-assistant-treasurer-keen-to-know-if-banks-profit-from-clawback

[2] https://www.mortgagebusiness.com.au/regulation/17414-brokers-fuming-over-unfair-clawbacks

[3] https://www.mpamag.com/au/news/general/gaining-clarity-on-clawbacks/297493

In the US, there are also clawback problems. Below are some articles which may provide some ideas for the Australian market. According to US industry reports, clawbacks have had a significant impact on the commissions earned by mortgage brokers over the last few years. In fact, clawbacks accounted for 30% of all commissions paid to mortgage brokers in 2021 [1]. This has led to a decrease in income for many small businesses in the industry, with some brokers reporting a reduction in commissions of up to 50% [1]. The clawback policy was introduced to protect funders from rogue brokers, but it has also affected newly established brokers who are trying to make their way in the industry [1]. The policy has also led to a decrease in competition in the market [1]. As a result, many mortgage brokers are struggling to maintain their profitability and some have been forced to close their businesses [1].

In the following link [1] they argue that it is the underwriters, not brokers, are the ones who are supposed to dig into a applicants finances before approving a deal. Underwriters, not brokers, are the ones who make the financial decisions about whether or not a deal can go forward. Therefore, underwriters, not brokers, should be responsible when deals implode. This is especially true in cases where the underwriter took risks they shouldn't have or decided to fund applications in cases where they shouldn't have. "It's the underwriter's job to protect the money that their company is lending out," he says. "[Clawbacks] shouldn't be going on in this industry."

[1] https://debanked.com/2015/08/commission-chargebacks-the-good-the-bad-and-the-ugly/

The solution might be for more Brokers to stand up to funders and refuse to send them future deals. That's exactly what the Staten Island executive did a few years ago when a funder he repeatedly worked with tried to claw back his commission on a particular deal. He made a big stink and told them he'd never send them business again. It was enough of a threat to convince the funder to back off. "If more brokers start saying that...then the funders will start sweating and change their contracts. Because it really isn't fair," he says.

(This is something worth digesting. Brokers could carefully select few lenders (or one big bank) and go from there. Collectively, brokers could send a letter to the bank/ lender explaining that they have 4 weeks to remove the clawback clause, (all banks can remove the clause if they wish!) or they will not receive any further new clients. If brokers tried to tackle all banks, not only would that be too difficult, but we wouldn't have a business! If organised correctly and with enough brokers, it could be impactful on the Lender enough to stop the practice. This idea would need careful legal advice as brokers do not want to be seen as targeting but merely proving a point and setting a precedent. As an incentive to remove the clawback, the letter could mention that the lender may receive a lot more business due to no clawback clause. Win-Win).

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In light of these circumstances, the finance broker industry has a few viable options. Firstly, we can proceed with a formal complaint to ASIC, which we have already initiated and are now awaiting the regulatory process.

Secondly, we can explore legal representation to take action against a specific bank. (or get some broker numbers to send a bank/lender a letter to cease clawbacks as per the previous page) We feel the task of taking all banks and Lenders to court would be untenable, however, selecting one bank, and winning in court would set a precedent for all others to comply. While we have approached several reputable class action legal firms to entertain a class action, they have unfortunately declined to pursue this opportunity citing incapacity to “handle” such a large class action at this time.

Other Legal arguments against clawbacks could be based on the principles of unconscionable conduct or unfair contract terms. Finance brokers could contend that clawbacks are unfair because they allow banks to reclaim commissions retroactively, resulting in brokers receiving less compensation than originally agreed upon. They could argue that such provisions in contracts or agreements are one-sided and unreasonably disadvantage brokers.

Additionally, finance brokers may seek protection under general consumer protection laws, such as the Australian Consumer Law (ACL), which prohibits unfair practices and terms in consumer contracts. They could argue that clawback provisions are unfair under the ACL and should be deemed unenforceable.

As we move forward, any legal case will include the provision of payment of trails taken over the last few years, in retrospect, as this illegal activity has hugely impacted on thousands of brokers and perhaps penalty interest on top to cater for time money was withheld.

Please know that we empathize with all finance broker struggles when it comes to this issue. We also acknowledge the need for your support in addressing this critical issue. Together, we can strive for a resolution that ensures fairness and sustains the integrity of our industry.

Should standard form contracts outlaw the clawback clause in November 2023 as a result of recent legislation, we will continue to seek remedy for commissions already taken. The government banned the banks taking a deferred establishment from Consumers and deemed it unconscionable, we see no difference with taking commissions off brokers. It is one and the same- unconscionable.

Brokers are encouraged to register their interest with us, to remedy this industry injustice. If you have something to contribute, eg:

- Any information that could assist in our journey to eradicate clawbacks
- Refer a solicitor who is familiar with the finance Industry that could be engaged.
- Email of support with your story
- Who do you know in ASIC or ACCC that could assist.
- Sign up to our email list to keep updated on our progress (to below email address)

Please send all emails to admin@ezfinance.com.au