Insurance Times

Court of Appeal ruling is ‘nail in the coffin’ for undisclosed broker commissions

By Clare Ruel | 23 November 2021

Premium finance provider has called for full transparency and disclosure around commissions

The conjoined *Wood v Commercial First Business and Ors* and *Business Mortgage Finance 4 v Pengelly* Court of Appeal ruling, which was handed down in March 2021, is the “nail in the coffin” for undisclosed broker commissions, according to Ravi Takhar, chief executive of premium finance provider Bexhill UK.

The cases involve two unconnected borrowers - Wood and Pengelly - who sought to cancel their respective mortgages on the grounds that the mortgage lender had paid commissions to the borrowers’ broker without their knowledge or informed consent. Wood and Pengelly had used the same broker.

Wood and Pengelly had defaulted on loan repayments, so the lenders involved started enforcement proceedings - this prompted the borrowers to bring their own counter claims in a bid to cancel their contracts and recover any undisclosed commission.

The two cases brought to the forefront discussions around fully and half secret broker commissions.

Read more...Brokers set to be 'squirming' as FCA fixates on product value

Not subscribed? Become a subscriber and access our premium content

Level of disclosure

The Court of Appeal ruled that there was "no fiduciary duty required to find liability" - meaning that the broker's failure to disclose its commission meant that both Wood and Pengelly were entitled to claim.

As a result of the judgment, the broker involved must now inform the relevant parties of the actual level of commission charged - failure to disclose this information could see the lenders demand a repayment of the commission.

Heather Rankin, senior associate in London at law firm Herbert Smith Freehills, explained: "In both cases, the broker's terms and conditions provided that 'we may receive fees from lenders with whom we place mortgages. Before we take out a mortgage, we will tell you the amount of the fee in writing.'

"The Court of Appeal held that these terms meant that the borrowers were entitled to assume that, because the broker had not disclosed any fees, they had not been paid. As a result, the fees received by the agent were a secret commission."

Takhar told *Insurance Times*: "Not many brokers disclose the commission they are making on finance to customers. Effectively, [brokers] are all now susceptible to a claim from the borrower to say 'pay the commission you made back'.

"The long and short of it is that there [are] billions of pounds of premium finance written every year and brokers are not disclosing how much they are making to the customer.

"Effectively, there is over 10 years, billions of pounds of claims against lenders for those commissions and then against brokers."

Takhar recommended that going forward, brokers should disclose their commissions - as well as the exact commission from their premium finance lender - to avoid potential claims being made against them. This is especially pertinent considering the FCA's renewed focus on fair value.

Read more...New premium finance rules – what does it mean for the industry?

Fair value and transparency

Historically, brokers have not disclosed these commissions, according to Takhar. He believes this is because brokers' commissions are quite high compared to the cost of finance and also, premium finance providers have not wanted those commissions disclosed.

Takhar continued: “The new FCA regulations say to act in the best interest of the customer. [The] specific rules are if you think the commissions would affect the decision of the customer to enter into the deal, it must be disclosed. But also, full disclosure is now required in respect to the total cost of premium finance.

“The FCA [is] indirectly saying that commissions should be disclosed.”

Under the FCA’s new pricing rules, brokers must inform customers of the cost of insurance premiums - both with and without finance.

Takhar said that if commissions are not disclosed as part of this, customers can ask for this figure directly and subsequently make a claim.

“The best way for the insurance industry to avoid this is to disclose commission,” he added.

This also applies to premium finance providers.

“If there were lots of historic claims for premium finance providers, it would be [those firms] that the first claim would be against. The premium finance providers would have to pay back the commission to the customer,” Takhar explained.