

Commerce Commission submission on Discussion Document: Consumer Credit Regulation

1 August 2018

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Introduction

1. This submission sets out the Commerce Commission's views on matters raised in the Ministry of Business Innovation and Employment's **(MBIE)** Discussion Paper relating to the Review of Consumer Credit Regulation.
2. The Discussion Paper identifies a number of specific issues arising in the provision of consumer credit in New Zealand, and with the operation of the Credit Contracts and Consumer Finance Act 2003 **(CCCFA)**. They are issues believed to contribute to problem debt and financial hardship in sections of the community. The Discussion Paper proposes some ways to address those issues. As the agency responsible under the CCCFA for consumer credit advocacy and enforcement of the Act we appreciate the opportunity to contribute to this process with this submission. We draw upon:
 - 2.1 Information obtained from stakeholders through our advocacy activities. Those stakeholders include borrowers, community agencies such as budget advisory services and a variety of lenders;
 - 2.2 Examples and patterns of conduct observed in our investigation and enforcement activity; and
 - 2.3 Our experience with enforcement of the provisions of CCCFA, including the 2015 amendments and our expectations of enforcement of various options for amendment which are mooted in the Discussion Paper.
3. When we refer in this submission to evidence that we have observed, we are referring to these sources of information and provide more specific referencing where appropriate. We are happy to expand on or clarify any matter raised in this submission.

Summary of views

4. We welcome review of both the experience of participants in New Zealand credit markets and the extent to which the CCCFA appropriately meets the needs of relevant stakeholders. The CCCFA is an important tool for regulating the provision of consumer credit. It is also lengthy and complex. Many lenders report difficulty in interpreting and applying it. At times, enforcement is also time consuming, resource intensive and complicated by the CCCFA's unwieldy structure and by ambiguities arising within it. Some, but not all, of the factors contributing to these difficulties are addressed in the Discussion Paper. While a wholesale review is beyond the scope of the current Discussion Paper, we consider it important that the impact of any amendment to the existing legislation is carefully considered in its wider legislative context to provide as much clarity and certainty as possible for lenders, borrowers and the Commission.
5. The Commission supports proposals in the Discussion Paper to:

- 5.1 set bright-line rules for lenders in respect of the Lender Responsibility Principles and bolster the protections they offer consumers;
 - 5.2 strengthen sanctions for breaches of the Lender Responsibility Principles; and
 - 5.3 amend the fee provisions to assist with their enforcement and make clear their interrelationship with proposals to reduce costs of borrowing for some categories of loans.
6. We consider that these proposals will better protect borrowers, assist lenders to understand what is required to comply with the CCCFA, and allow us to most efficiently identify non-compliance and take appropriate enforcement action. We also address the potential for other options for change described by the Discussion Paper.

Issue 1: Excessive cost of some consumer credit agreements

1 Do you agree that the problems identified with high-cost lending (even where it is compliant with the CCCFA) are significant? Do you have any information or data that sheds light on their frequency and severity?

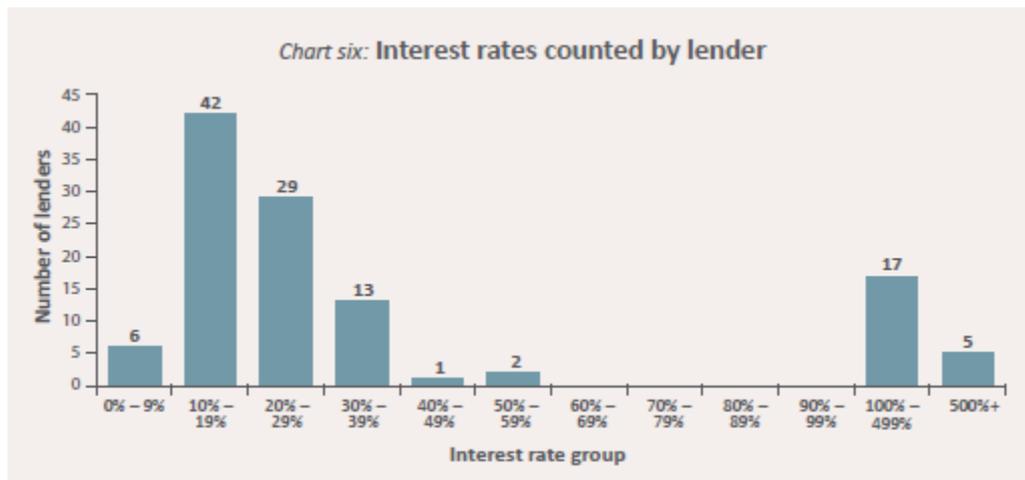
7. We have seen evidence of high-cost consumer credit offered with interest rates and fees greatly in excess of those applying to other consumer credit products. These costs of borrowing affect all borrowers whether they are able to repay their loan, or end up in default.
8. We have also seen significant evidence of borrowers experiencing compounding financial hardship when using high-cost credit. In some circumstances it appears that lender compliance with responsible lending requirements ought to have restricted access to high-cost credit for borrowers who have subsequently experienced financial hardship.
9. In particular we are aware of:
 - 9.1 large numbers of borrowers with high-cost loans who are not able to repay the loans and either:
 - 9.1.1 miss payments or re-arrange them giving rise to increased costs of borrowing such as default fees and/or interest; or
 - 9.1.2 pay them off with another high-cost loan converting a short term high-cost credit solution into a longer term, high-cost source of credit and creating additional liability for fees such as establishment fees; and
 - 9.2 some high-cost lenders are aggressively advertising and lending to borrowers who have had multiple high-cost loans and/or are in default on other high-cost loans with that lender, or with other lenders.
10. High-cost short term loans can provide a useful credit option for borrowers with genuine one off and short term needs. However, these patterns of high-cost compounding use and financial hardship suggest that short term high-cost products may often be unaffordable and/or unsuitable to meet the needs of the borrower, and are potentially used as longer term sources of credit with higher cost than other forms of medium to long term credit.

The high-cost credit industry

11. In 2016 the Commission sought information from nine high-cost lenders about loans they had entered into between 1 September 2015 and 30 September 2015 (**2016 High-Cost Credit Review**). On average these lenders each entered into 1201 loans during this period with total value (including principle and interest) of \$452,242 per

lender. If extrapolated over a 12 month period, these figures would suggest that these nine lenders could be entering into up to 131,558 loans a year (14,617 per lender) with a total value of \$49.5m (\$5.5m per lender). As is well understood, the market comprises many more high-cost short term lenders than this small sample.

12. In our 2017/18 Lender Website Review (**Lender Website Review**) we identified 24 lenders charging an interest rate of 50% or more.¹ These lenders would meet the definition of a High-Cost Short Term lender for the purposes of the Responsible Lending Code which suggests that greater responsible lending requirements apply to them than to other lenders.
13. Of the 217 websites considered in our Lender Website Review, 115 lenders displayed an annual rate of interest. The chart below shows the distribution of interest rates displayed by those lenders.² Twenty percent of lenders advertised an annual interest rate of over 50%. This is not a rate reflecting the annualised total cost of credit including interest and fees, which can be used to compare the actual cost of borrowing from different lenders (**Comparison Rate**). We would expect the percentage of lenders offering a comparison rate of over 50% to be much higher.



Prevalence of lending, default and refinancing

14. Based on our 2016 High-Cost Credit Review, it appears that, despite the introduction of responsible lending requirements in 2015 many borrowers are entering into high-cost loans that they cannot repay:
 - 14.1 In 25% of the loans entered into by the nine lenders we contacted, borrowers missed or re-arranged a payment.
 - 14.2 The percentage of contracts that were not paid in full in accordance with the terms and conditions ranged from 2% to 63%.

¹ Commerce Commission "Lender Website Review 2017/18" (31 May 2018).

² At 13.

- 14.3 One lender advised that 48% of loans entered into during the relevant period had outstanding balances after 4 months (in circumstances where the loan term was 4-8 weeks). Only 35% of its loans were repaid in accordance with the original terms and conditions and 63% of its customers missed or rearranged payments.
15. Lenders also roll over high-cost loans. We asked the nine lenders how many of their contracts were to new customers and how many were to existing customers. Eight lenders responded to this question.
- 15.1 Four lenders acknowledged that a proportion of their loans were paid off by a new high-cost loan.
- 15.2 One lender disclosed that, of loans repaid in full during the relevant period, 52% were repaid, in part, by another high-cost loan from that lender.
16. In one investigation of a high-cost lender, the Commission considered a sample of 182 loans made to 21 borrowers entered into between 17 June 2015 and 24 February 2017. Of those loans 50% were second or subsequent loans given to borrowers either on the same day or the day after the previous loan had been repaid. These borrowers had, on average, 9 loans each over this period.

Example A

On 1 July 2016, Borrower A applied for his first loan from Lender A. He reported his income as being \$500 per week. He was not required to provide any details about his living expenses or why he wanted the loan. He was given a "scored amount" of \$200 and was approved a \$200 loan. Borrower A repaid this loan seven days late.

Two days later, on 5 August 2016, Borrower A applied for a \$400 loan from Lender A. The lender assessed that he was able to pay \$300 and he was offered a \$300 loan. Borrower A repaid this loan 10 days late.

Borrower A was approved two additional loans with only one day in between each loan. The first was for \$300 (which he paid back only three days late) and the last was for \$500. Borrower A was unable to repay the last loan.

The Statement of Account showed that as at 8 November 2016, he had repaid \$759 and still owed \$408 on the last loan.

Lending when in default

17. The same investigation also revealed that the lender:

- 17.1 sent emails and texts to customers who were in default advising the customers they could immediately re-apply for further loans of greater amounts; and
- 17.2 approved further loans after sighting bank statements which showed the borrowers were in default and had other high-cost loans.

Interest rates and fees

- 18. Our Lender Website Review looked at whether a group of online lenders in New Zealand were likely to be complying with their responsibilities under the CCCFA to display key information prominently and clearly on their websites such as contract details, interest rates and fees. It also gathered information about lenders' published interest rates and fees. We refer to that report as a useful source of information relating to the variable level of interest rates and fees offered by those lenders.
- 19. The courts themselves have increasingly expressed concern about the costs of some credit contracts. The Commission has been asked to intervene in three cases where the reasonableness of the lenders' charges has been in issue and the courts have considered on their own volition whether to reopen the contracts on the grounds of oppression. In those cases the courts have called into question the amount of fees and interest charged on loans and the length of time for which default interest is charged.³ The High Court in *Diners Club (NZ) Limited v Auckland District Court* [2017] NZHC 2616 was asked to consider what evidence would be required to demonstrate that a loan was oppressive:

In the course of oral argument Mr Katz did accept, however, that there may be exceptional cases where it was apparent on the face of the contract or pleadings that a contract was (or was likely to be) oppressive. An example would be a routine consumer contract that included an interest rate of 500 per cent.⁴

- 20. We also see first-hand through our investigation and enforcement work examples of lenders charging extremely high interest rates and fees.

Example B

Borrower B borrowed \$50 from Lender B. The contract required that she make five weekly payments, four of \$29 and a final payment of \$27.91 for a total of \$143.91. The cost of credit included an establishment fee of \$64 and interest at 365% per annum of \$29.91 giving an annual percentage rate of 2,481%

³ *Moola.co.nz Limited v Daniel Mapu, Santana Stone & Ors* DC Christchurch CIV-2016-0093195 and CIV-2017-009-000704; *Real Finance Limited v Setefano* [2017] NZDC 27629.

⁴ *Diners Club (NZ) Limited v Auckland District Court* [2017] NZHC 2616 at [34].

Concluding observations

21. These examples confirm that the issues identified in the Discussion Paper - frequent use of high-cost loans, debt spirals, and comparably high interest and fees – are also identified in our work. The Commission also receives anecdotal evidence from community advisers, who work with affected borrowers, that these issues contribute to the harms described in the Discussion Paper. For example, that they exacerbate the financial hardship experienced by their clients and dramatically escalate costs of borrowing beyond the point where borrowers feel that they have any practical ability to repay their debts.
22. Our investigations into potential non-compliance with the CCCFA and our enforcement action to date in relation to these matters has focused upon whether:
 - 22.1 Responsible Lending Principles are being complied with, including whether proper suitability and affordability assessments have been made;
 - 22.2 advertising of loans to existing customers is responsible;
 - 22.3 lenders have taken steps to help borrowers to understand the full implications of entering loan agreements; and/or
 - 22.4 high interest rates may have contributed to a course of oppressive conduct.

The Commission currently has five active investigations into allegations of breaches of the Lender Responsibility Principles and/or oppression. Two involve lenders charging more than 50% interest annually and one involves a trader who sells goods at prices higher than comparable prices available from other retailers.

In May 2018, the Commission filed proceedings against Ferratum Limited alleging breaches of the Lender Responsibility Principles including allegations that Ferratum advertised new loan to borrowers who were already in default.

Options for addressing high interest and fees

2	Do you support any of the extensions of Cap Option A? What would be the impact of these extensions on lenders and borrowers? Do you have any information or data that would support our assessment of the impact of these extensions?
3	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
4	Do you have any suggestions for the design of options for capping interest and fees? If so, what would be the impact of your proposed design on borrowers, lenders and the credit markets?
5	Which interest rate cap options, if any, would you prefer? Which interest rate options would you not support? Please explain how you made your assessment.

General comments on proposed caps and restrictions

23. Earlier in our submission we have referred to data and anecdotal evidence relating to interest rates and fees charged for high-cost loans and borrowers' experiences of them. The Discussion Paper proposes three options for capping interest rates and fees in an attempt to address what it identifies as the excessive cost and use of these consumer credit agreements. We do not comment in this submission upon whether the Discussion Paper accurately identifies the nature and extent of consumer harm or the extent to which any option may reduce that harm. This is largely a matter of policy for consideration by the review on all the evidence available to it. Our submission seeks to identify the impact that we consider the proposed options may have on enforcement of the CCCFA and the industry generally.
24. At the outset, we make a number of general comments applicable to all cap options proposed in the Discussion Paper and then we discuss each option in turn. We do not express a preference for opinion of one option or another but comment below on issues we consider relevant to the potential enforcement and effect of each option.

Clarity and certainty are important

25. Any interest rate and fee cap or limit on high-cost lending should be drafted as a clear and unambiguous obligation, particularly if the caps are restricted to high-cost lending and it is necessary for lenders to readily identify which loans are capped and which are not. In our experience bright-line rules are easier to enforce and there is evidence from Australia that they lead to better compliance among payday lenders. The Australian Securities and Investment Commission (**ASIC**) identified that unambiguous obligations:

- 25.1 are more likely to achieve desired outcomes;
- 25.2 may reduce complexity and compliance costs for businesses; and
- 25.3 may even the playing field for lenders who already have more robust compliance processes.⁵

Scope for avoidance should be considered

- 26. Any cap should remove, as far as possible, opportunities for lenders who are intended to be subject to the cap to avoid it by using particular business models or by structuring their transactions in particular ways. Consideration should be given to the following factors in order to reduce avoidance:
 - 26.1 The definition of a high-cost lender. This is a matter related to the need for clarity and certainty in drafting. In addition, avoidance is likely to be an issue if the definition is determined by an amount or term of a loan. Lenders could avoid the caps by offering loans just outside of those parameters. Appropriately capturing the right loans will require careful consideration. In Australia, Small Amount Credit Contracts (**SACC**) are defined as being loans of up to \$2000 where the term is between 16 days and 12 months. The lenders we contacted as part of our high-cost lender review offered loans ranging from \$30 to \$1895 for a maximum term of 336 days. However, we are aware of potential problems with medium length contracts too. We are increasingly seeing lenders offering high-cost medium term contracts. We are aware of one lender offering loans for 18 months at over 500% interest.
 - 26.2 Whether any cap should be extended to other types of transactions that include, in substance or effect, a cost of credit. For example whether consumer leases or credit sales should also be subject to a high-cost credit cap. We also understand that regulators in the UK and in Australia have raised concerns about the cost of consumer leases or rent-to-own arrangements.⁶
- 27. Anti-avoidance mechanisms are usefully discussed in a Regulation Impact Statement issued by the Australian Government addressing problems associated with avoidance in the context of the Phase Two of credit reforms.⁷ We consider this discussion is also relevant to consideration of caps in New Zealand.

⁵ ASIC "Submissions on Review of the Small Amount Credit Contract Laws (October 2015).

⁶ The Australian Treasury has proposed to impose a cap on the total payments that can be made under a consumer lease to address concerns about regulatory arbitrage resulting from traders drafting contracts as consumer leases to avoid caps on credit contracts (National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017, Exposure Draft).

⁷ National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017, Exposure Draft Explanatory Materials at 49.

Interrelationship with the broader provisions of the CCCFA is important

28. We agree that any interest rate caps should include fees. However, the introduction of any cap should take into account the way that cost of credit is required to be disclosed (including any regulation of fees) and any changes made to those provisions as a consequence of this review. We discuss this further below in relation to Issue 4 on fees. .
29. In addition, the introduction of any cap should balance the interrelated policy objectives of caps and responsible lending provisions. The Discussion Paper identifies that an alternative to capping interest rates and fees is to rely on the options proposed to address irresponsible lending and other non-compliance.⁸ Caps may primarily influence the cost of credit provided to individual borrowers. However, to the extent that sanctions for irresponsible lending are intended to deter the extension of credit to those unable to afford it or for whom other forms of credit are more suitable, there may be some overlap between the policy objectives pursued through caps on interest and fees and irresponsible lending. We encourage consideration of this when considering the introduction of caps and amendment to responsible lending obligations.

Default fees to fall within any cap

30. The proposals in the Discussion Paper to introduce accumulation limits include default costs. We consider that these costs are a critical factor for borrowers experiencing debt spirals. In our experience many high-cost loans, despite very high annual interest rates, do not require borrowers to repay more than 100% of the loan amount as long as the borrower does not default. However, the cost of the loans creates a high risk of default and the cost of default is significant. The impact of any cap will therefore be greater if it includes, rather than excludes, the cost of default.
31. For example in one investigation into a high-cost lender we received a sample of 192 loans. Analysis shows that only 29 of those loans required the borrower to repay more than 100% of the original loan amount (absent default fees and interest charges).
32. In another investigation involving a high-cost lender an analysis of 133 loans showed that the costs of borrowing over the life of the loan were all under 100% of the principal.

Appropriate sanction for breach of any cap is important

33. There should be appropriate penalties for breach of any interest rate caps. We suggest that remedies could include pecuniary penalties, injunctive relief, statutory damages and/or refunds of costs of borrowing. We discuss these remedies later in this submission when discussing Lender Responsibility Principles.

⁸ Additional Information to Support the Discussion Paper (**Additional Information Paper**) at [93].

Other industry impacts to consider

34. We also suggest that in setting interest rate caps MBIE should consider the following potential industry impacts:
- 34.1 Interest rate caps may incentivise lenders to lend responsibly by reducing their ability to profit overall. Lenders may be more risk averse in their lending decisions if they cannot charge high interest rates; they will be unable to rely on high payments made by paying debtors to cross-subsidise the cost of bad debts.
- 34.2 Interest rate caps may result in a reduction in the number of lenders in the industry.
- 34.3 Achieving the harm reduction objectives identified in the Discussion Paper may inevitably restrict access to credit for some borrowers in need. Separate provision may be required to meet their needs, and in particular consideration should be given to promoting sources of responsible lending for short terms or low amounts. In our experience, many borrowers who become trapped in high-cost borrowing had unexpected expenses and other life events that impelled them to borrow. The borrower's need for credit is very often genuine and the review should consider the availability of responsible or ethical alternatives.
35. In the event that stronger regulation of high-cost lenders contributed to an increase in lending that does not comply with the CCCFA, we consider that we are well placed to take appropriate investigative and enforcement action. For example in relation to lenders who have not taken the basic step of registering:
- 35.1 In 2015 we prosecuted Yuan Rong Yang for breaches of the CCCFA including for operating as a financial service provider without being registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSPA**). In sentencing the District Court said it was satisfied that Mr Yan was an unlicensed money lender.⁹
- 35.2 In 2016 we prosecuted Gavin Marsich for breaches of the CCCFA including for being party to misrepresentations that Twenty Fifty Club Limited was a registered financial service provider.¹⁰
36. If an interest rate and fee cap is to be introduced, closely aligning the caps with an Australian model would enhance trans-Tasman uniformity. In circumstances where Australian-based high-cost lenders are increasingly lending into New Zealand,¹¹ and there are close relationships between Australian and New Zealand banks, there will

⁹ *Commerce Commission v Yuan Rong Yang* DC Auckland CRI-2015-004-003184 2 October 2015.

¹⁰ *Commerce Commission v Twenty Fifty Club Ltd* DC Manukau CRI-2014-092-12492 26 April 2016.

¹¹ For example, Credit Corp New Zealand Pty Limited and Quadsaa Pty Limited.

be efficiencies for regulators and market participants in ensuring relatively consistent regulatory mechanisms, even if specific cap limits differ.

Cap Option A: limit the accumulation of interest and fees

37. This option would apply only to high-cost lenders. It proposes to limit the accumulation of interest and fees (including default fees) to 100% of the original principal (**the accumulation limit**) with two possible extensions:
- 37.1 prohibiting offering a high-cost loan (or a refinancing agreement) to someone already in default on a high-cost loan; and/or
 - 37.2 imposing a limit of one high-cost loan per borrower; and/or
 - 37.3 a “cooling off” period of 30-90 days before a borrower can take out another high-cost loan.
38. By way of general comment we note:
- 38.1 Responsible lending requirements also address some of the harms targeted with the proposed cap extensions and, as noted above, we encourage balancing of the interrelated policy objectives of caps and responsible lending provisions and consideration of any overlap in enforcement of those sets of provisions.
 - 38.2 The benefits of the cap and its extensions target different identified harms and may be different for borrowers who default and borrowers who do not default on their loans.

Reducing the cost of borrowing

39. The cap proposed by Option A may reduce the cost of borrowing on some high-cost loans. However, the extent of the impact will vary greatly depending on the amount borrowed and the term of the loan. For example, this option most likely allows lenders to continue to charge high interest rates on very short term loans and may only reduce the cost of the loan for longer term loans.
40. We consider the proposed cap is likely to deal most effectively with the cost of loans that are in default for borrowers who would otherwise accumulate default and interest and fees without limit.
41. Importantly, we agree with the Discussion Paper that this option without any extension could limit the cost of loans and refinancing with a single lender, but may be ineffective to prevent the borrower refinancing with different lenders and may not achieve some of the policy objectives proposed in the Discussion Paper.¹² We discuss the importance of the extensions to address this issue if Option A is adopted.

¹² Additional Information Paper at [107].

On the other hand however, we note that care should be taken in the design of this option to avoid inadvertently restricting borrowers from refinancing high-cost loans to another loan at an advantageously lower rate.

Reducing overuse of high-cost credit

42. We consider the first proposed extension - to prohibit offering a high-cost loan (or a refinancing agreement) to someone already in default on a high-cost loan - is required to realise the benefits of the cap for defaulting borrowers who might otherwise refinance their loan with the same, or another, high-cost lender. We understand that it is common for borrowers to convert a high-cost short term finance option into a longer term high-cost option which in many cases attracts a fresh establishment fee for each successive refinancing.
43. An extension to limit high-cost loans to one per borrower targets the concurrent use of multiple high-cost loans which could reduce their overall use and the cost of borrowing for some borrowers.
44. A cooling off period may limit the successive use of high-cost loans and in so doing reduce the prospect of refinancing high-cost loans with other high-cost loans. The Financial Conduct Authority which is responsible for regulating consumer credit in the United Kingdom currently has restrictions on the roll-overs of high-cost loans.¹³ This could reduce the successive or frequent use of high-cost loans, as well as providing greater protection for those borrowers who are vulnerable to aggressive marketing of new high-cost loans on repayment of a loan. To be effective, we consider the cooling off period would need to apply to access to a loan from all high-cost lenders and not only the lender from whom a borrower has most recently obtained a loan.
45. The length of any cooling-off period should be given careful consideration so as not to unnecessarily restrict access to credit. We are aware that some seasonal or part-time workers use high-cost loans to make ends meet between jobs. An unduly short cooling off period may affect their ability to do this. The genuine needs of other borrowers may also require consideration.

Application to loans offered by all high-cost lenders important

46. The way in which restrictions on refinancing and holding multiple or successive loans are enforced will require careful consideration:
 - 46.1 Lenders will need reliable access to information about a particular borrowers' use of high-cost loans with other lenders, as well as to their own lending history with the borrower. Other jurisdictions have discussed or adopted a real time database of high-cost loans in order to enable lenders to obtain this

¹³ Lenders must limit extensions of loans to two roll-overs (Financial Conduct Authority: Policy Statement PS14/3).

information.¹⁴ Unless there is a method of obtaining the information, compliance with, and enforcement of, restrictions against access to multiple and/or successive high-cost loans will be very difficult and the purpose of the restrictions will be undermined. We do not consider that a requirement to obtain bank statements would be sufficient. Those statements would not necessarily show the last time the borrower obtained a high-cost loan and it is not certain that they could be relied upon to show whether the borrower was in default on an existing high-cost loan.

- 46.2 Instead of a blanket restriction, the extensions could take the form of a rebuttable presumption that a loan granted in these circumstances is unsuitable, or a requirement on lenders to make reasonable inquiries about whether the extensions apply. However, we consider that these qualifications would also limit the effectiveness of the extensions by enabling lenders to rely exclusively on information they receive from borrowers. Anecdotal evidence we have collected from lenders, borrowers and their advisers confirms ASIC's suggestion that this is likely to reduce effectiveness of a cap. Borrowers may obscure the existence of other lending in order to obtain credit. There is also a risk that lender may not take sufficient care with their inquiries so that the extensions provide no greater protection than existing responsible lending requirements.

Other cap design considerations

47. If Cap Option A is adopted, we note the following additional considerations for its design.
- 47.1 We consider that direct debit fees and fees charged by third parties and passed on by the lender, should be included in the cap.¹⁵
- 47.2 The cap should explicitly address whether enforcement expenses (being the lenders' expenses in going to court) will be included in the interest and fees limit. Our view is that these expenses should sit outside the interest and fees limit as these expenses are difficult for lenders to quantify until enforcement action is taken.
- 47.3 We also suggest that lenders should be required to provide borrowers with a statement at the beginning of the loan that they will not be required to pay more than the accumulation limit. Lenders could also be required to tell borrowers when the unpaid balance of the loan reaches the accumulation limit. This will ensure that borrowers are aware of the limit, can detect non-compliance and take appropriate action themselves.

¹⁴ ASIC "Submissions on Review of the Small Amount Credit Contract Laws" (October 2015).

¹⁵ ASIC Credit (Repeal) Instrument 2016/1087.

Trans-Tasman insights into cap effectiveness

48. We note that the effectiveness of a similar cap and extensions proposed under Option A are discussed in ASIC's 2015 Submission on the Review of Small Amount Credit Contracts Laws and that the Australian Government has accepted various recommendations relating to SACC law¹⁶ that may be useful to consider in the New Zealand context.¹⁷ The recommendations include:
- 48.1 removing the rebuttable presumptions about suitability, namely that a loan is unsuitable if the borrower has entered into two or more small amount credit contracts in the past 90 days or is in default under a small amount contract and limiting payments for high-cost loans to 10% of the borrowers' net income;
 - 48.2 requiring SACC's to have equal repayments over the life of the loan; and
 - 48.3 incorporating direct debit fees into the existing SACC fee cap.

Cap Option B: Reduce the highest interest rates and limit the accumulation of interest and fees

49. This option would only apply to high-cost lenders and involves:
- 49.1 limiting interest and fees to:
 - 49.1.1 a prescribed annual interest rate; or
 - 49.1.2 separate caps on interest, establishment fees and ongoing account maintenance fees; or
 - 49.1.3 an "equivalent interest rate" of 200-300%; and
 - 49.2 prohibiting default interest exceeding normal interest rates and limiting default fees to \$30; and
 - 49.3 limiting the accumulation of interest and fees to 100% of the original principal.
50. A cap on interest rates has a more direct impact on the total cost of borrowing for each loan. This is in addition to capping the accumulation of interest and fees overall. Based on the information available this option appears likely to reduce the overall cost of high-cost loans.

¹⁶ Small amount credit contracts are loans of up to \$2,000 where the term of the contract is between 16 days and 12 months.

¹⁷ National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reform) Bill 2017, Exposure Draft Explanatory Materials.

51. The effectiveness and enforceability of this option is more acutely dependent upon the treatment of fees under the CCCFA. We discuss the treatment of fees later in this submission but note:
- 51.1 If an annual interest rate cap is adopted, fees provisions would need to be sufficiently robust to protect against lenders increasing fees to compensate for revenue foregone on interest.
 - 51.2 If fees were subject to separate fee caps under this option the review would need to consider how the cost of credit should be disclosed and whether fees should also be reasonable under s41, or incorporated in an annual percentage rate with no requirement that they also be reasonable.
 - 51.3 If interest and fees are limited by way of a cap on the equivalent or effective interest rate there needs to be clear rules about how that rate is calculated and what fees are taken into account. We suggest that any equivalent interest rate includes all unavoidable/ mandatory credit fees (including broking fees, establishment fees, compulsory credit related insurance and administration fees) and also direct debit fees. We suggest that the calculation of equivalent interest rates should take into account when interest is charged. We are aware of high-cost lenders who are compounding interest daily.
52. We consider that it is important that any equivalent interest rate is disclosed to individual borrowers, for example as part of the information referred to in Schedule 1 of the CCCFA, if it is adopted under either Option B or C. Appropriate requirements for the disclosure of individual applicable fees will also be required.
53. We have noted above some limitations to the extensions to the proposed Cap Option A. However, if Cap Option B was to be adopted, it may be necessary to consider those extensions in addition to Cap Option B to advance the identified policy objective of reducing overuse of high-cost credit for the reasons discussed above.

Cap Option C: Set a low interest rate cap to eliminate high-cost lending

54. This option proposes to cap interest and fees for all loans using an equivalent interest rate of 30-50%.
55. There should be clear rules about how that rate is calculated and what fees are taken into account. Our comments about what should be taken into account in setting equivalent or effective interest rates above apply here.
56. Cap Option C is more likely to inherently reduce the potential for avoidance by covering the entire consumer lending industry. However, reform will need to consider whether an industry-wide equivalent interest rate cap should include other types of transactions such as credit sales or consumer leases as discussed above.

Potential effect on industry

57. We agree that the adoption of Cap Option C would invariably result in high-cost lenders leaving the industry. Some high-cost lenders appear to rely entirely on recovering a high-cost of credit from paying borrowers to subsidise borrowers that default: they take a risk that a percentage of loans will not be repaid and recover high interest rate or fees from the bulk of borrowers. One lender we have investigated has told us that it does not pursue bad debts at all and simply writes them off after three months
58. The review will need to consider whether there is a need to ensure through other means that borrowers have the ability to access emergency credit.

Other design options

59. We also consider that it would be possible to adopt combinations of the Cap Options (i.e. Option A or B and C (for other than high-cost lenders)). This may reduce the identified harm caused by high-cost loans while reducing harm caused by excessive costs in the lending industry as a whole. It may also mitigate against the risk of avoidance by high-cost lenders. For example, if a lender successfully avoided the limits imposed by the rules applying to high-cost loans they would nevertheless be subject to a lower interest rate cap of 30-50%.

Issue 2: Continued irresponsible lending and other non-compliance

6	If directors have duties to take reasonable steps to ensure that the creditor complies with its' CCCFA obligations, should any duties apply to senior managers?
7	If there are to be more prescriptive requirements for conducting affordability assessments, what types of lenders or loans should these apply to?
8	Should there be any change to the requirement that lenders can rely on information provided by the borrower unless the lender has reasonable grounds to believe the information is not reliable? What would be the impact of a change on borrowers, lenders and the credit markets?
9	Do you consider there should be any changes to the current advertising requirements in the Responsible Lending Code? If so, what would be the impact of those changes on borrowers, lenders and the credit markets?
10	Do you agree with our assessment of the costs and benefits of the options reduce irresponsible lending and other non-compliance? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
11	Do you have any suggestions for the design of options for reducing irresponsible lending and other non-compliance? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
12	Which options for reducing irresponsible lending and other non-compliance would you support? Which would you not support? Please explain how you made your assessment.

60. We are aware of evidence supporting the issues identified in the Discussion Paper under the heading of continued irresponsible lending and other non-compliance, and we welcome reform that assists us with enforcement of the Lender Responsibility Principles. However, we do not accept that compliance with the current Lender Responsibility Principles is particularly burdensome or difficult.

Options for increasing lender registration requirements

61. We support some of the options for increasing lender registration requirements. Our view on each option is described further below. We first make some general observations about the need for, and benefits of, a stronger licensing regime.

Avoiding sanction for CCCFA breaches

62. There is evidence that some lenders use “phoenix” companies to continue to lend after they have been subject to enforcement action or investigation by the Commission. We are aware of companies that, after investigation or prosecution by the Commission, go into liquidation, sell their loan book to a “new” company and keep collecting on loan accounts. This has also occurred in circumstances where we have proceeded against a company and obtained a banning order against a company rather than an individual (due to difficulties in proving intent or specific culpable conduct on the part of an individual).

Cash to You Loans Limited

The Commerce Commission prosecuted Cash to You Loans Limited in 2017 for breaches of the CCCFA including charging default interest of 35% when the loan agreement stated no interest would be charged on default. The company was fined \$28,000 and was banned indefinitely from operating as a lender. The Commission had originally applied to ban the director from lending but withdrew the application after the Court indicated that it was not minded to grant a banning order in circumstances where the director had not been charged personally (despite the CCCFA not requiring this).

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Lender C

The Commission commenced an investigation into Lender C in 2016 for potential breaches of the Fair Trading Act 1986 relating to allegations that it had charged interest and fees after consumer goods had been repossessed and sold. In May 2016 Lender C went into liquidation. In 2017 the liquidator confirmed that the loan book had been sold to another company with the same husband and wife directors and shareholders as Lender C.

Register does not currently provide clear information

63. It is also often difficult to identify companies operating in the industry and the extent of their obligations. For example, the Financial Service Providers Register (**FSPR**) currently does not record whether lenders are providing consumer credit – just whether the lender is providing credit under a credit contract.

Changing consumer credit landscape

64. The barriers to setting up as a lender are low and, in our experience the industry is fluid. For example, of the 20 mobile traders we considered as in our 2014/15 Mobile Trader Project (**Mobile Trader Project**)¹⁸ that are the subject of investigation or have been subject to enforcement action:
- 64.1 three have been placed into liquidation or removed from the companies register. Two of those lenders are associated with another company that is still lending.
 - 64.2 three lenders have changed their company names.
 - 64.3 seven have told us that they have stopped selling door to door (although they continue to be registered on the Companies Register and FSPR). We are aware that the directors of two of these companies are associated with new companies operating truck shops.

Option A: Expanded powers to deregister lenders and ban directors from future involvement in the industry

Deregistration powers

65. In our view the power to deregister, as set out in the Discussion Paper, does not provide substantial additional benefit over the existing ability for the Commission to seek a banning order. We also consider that, given the seriousness of the sanction, there is benefit in retaining judicial oversight (or at least an independent assessment) of Commission applications to remove lenders from the industry.
66. We are of the view that the proposed criteria for deregistration would not be more effective or efficient than banning orders in removing predatory or irresponsible lenders from the market because:
- 66.1 The ability to apply for deregistration outside of a court process does not provide any enforcement efficiencies. Where the criteria for deregistration are triggered by a conviction for a CCCFA offence, we would be likely to seek a banning order at the time of conviction. This retains the check and balance provided by judicial decision-making and renders a power to direct deregistration redundant.
 - 66.2 We can of course seek a banning order at any time. It need not be in conjunction with prosecution for breaches of the CCCFA. In addition, management banning orders can be sought against an individual or a company. We do not consider that the individual needs to be charged in order to be the subject of a management banning order, despite suggestion by the District Court that this may be the case.

¹⁸ Commerce Commission “Mobile Trader 2014/15” (27 August 2015).

- 66.3 It is not clear that deregistration would necessarily be any faster if lenders were given the right to appeal any deregistration direction of the Commission.
- 66.4 The proposed criteria for deregistration set out in the background and technical details paper are broadly similar to the existing criteria for seeking a banning order.
- 66.5 Deregistration does not have a different or wider effect than a banning order nor are there different enforcement consequences associated with deregistration. In fact, banning orders have a broader effect than deregistration. They prevent individuals from lending, operating in the industry and from operating lending businesses for the duration of the order. Deregistration may not be permanent and may not stop individuals reregistering a new corporate entity.¹⁹
- 66.6 The penalties for breaching a banning order are also higher than for lending without being registered.
67. We do consider, however, that there should be some power to deregister a lender in circumstances where the registration criteria (e.g. fitness to lend) are no longer met, where they were met at the outset. Any organisation tasked with considering deregistration should be sufficiently resourced to undertake that task.

Banning order provisions

68. The amendments to the banning order provisions may assist the Commission when seeking management banning orders against individuals and the additional criteria discussed are relevant to the question of whether a person should be engaging in credit activities. However, the ability to obtain a banning order against a company should remain in any change to s 108 of the CCCFA.
69. In relation to the proposed criteria, we recommend:
- 69.1 A single breach of the FSPA should be enough to trigger a banning order application. It is unlikely that a lender would breach the FSPA twice in the same course of conduct, for example by being in the business of lending without being registered.
- 69.2 A single Crimes Act 1961 conviction should be sufficient to trigger a banning order application. Currently a person only needs one conviction of s 217-265 of the Crimes Act to trigger the banning order provisions. The proposal requires two convictions, so Option A may make it harder than presently to obtain a banning order in some circumstances.

¹⁹ Unless a fit and proper person test is also introduced for registration purposes and whether an individual had been deregistration was relevant for that.

- 69.3 If director duties are introduced, a failure to comply with these duties should also be relevant to banning orders.
- 69.4 An individual should have been a director concerned in the management of a creditor *at the time* that the law was contravened. This is a current requirement of s 108(1)(a)(vi) of the CCCFA.
- 69.5 The review may also consider whether any new s 108 should retain scope for the court to consider potential disproportionate effects of any ban as is currently provided in s 108 of the CCCFA.
70. We also recommend that the CCCFA clarifies that banning orders are triggered on an order to pay civil pecuniary penalties (if they are introduced), not merely upon criminal conviction.
71. It is not clear whether the alternative banning order threshold proposed in the Additional Information Paper is a higher or lower threshold than the current “not a fit and proper person test”.²⁰
72. In the circumstances we would suggest that the “fit and proper person” criteria at s 108(1)(b) is retained but that an additional criterion is added:

Where the person is an individual, whether that person is a fit and proper person to be a director or principal officer of a body corporate that enters into consumer credit contracts as a creditor.

Option B: Introduce fit and proper person test

73. We consider that the introduction of a fit and proper person assessment for registration in addition to the existing requirements could reduce the risk that individuals who are likely to engage in predatory or irresponsible lending are able to legally enter the market.
74. However, the review would need to carefully consider evidence supporting the effectiveness of the proposed regime in achieving these objectives, and weigh this against the cost of establishing and administering such a regime. We are conscious that there will be significant costs associated with establishing and maintaining any new system to implement this proposal. Any organisation tasked with making these assessments would need to be adequately resourced to do it. While it may be possible to leverage off current registration and licencing systems, careful consideration would need to be given to how this would work in practice. It may be possible to reduce the costs associated with implementing such a test by making it a requirement for registration on the FSPR (which is currently administered by MBIE).

²⁰ Additional Information Paper at 37: The new test requires a court to be satisfied the order is “necessary to protect the public from the risk that the person... will contravene the CCCFA”.

75. In the event that a fit and proper person assessment was adopted, we discuss some matters for consideration below.
76. Introducing a fit and proper person assessment as a registration requirement is consistent with the application of that test for a banning order. It makes sense to prevent anyone from entering the sector who is not a fit and proper person, if they could be banned from operating on the same grounds.
77. There are lenders in the industry who have criminal convictions and have engaged in conduct that has harmed consumers. For example Budget Loans was able to register on the FSPR despite the fact that its director, Allan Hawkins, had served a custodial sentence after being found guilty of fraud in connection with Equiticorp Limited in 1992.
78. Fit and proper person tests are common across a number of licensing schemes and professional standards found in the statute book, including the Civil Aviation Act 1990, Lawyers and Conveyancers Act 2006, Financial Advisers Act 2008, Real Estate Agents Act 2008, Social Workers Registration Act 2003, and Medicines Act 1981. These schemes provide useful guidance on the type of factors that should be considered when administering the test.
79. It is important to have clear standards to guide applicants on how to demonstrate their fitness and propriety. We are in favour of stating the factors taken into account in such an assessment in the CCCFA, or in a separate instrument referred to by the CCCFA as is the case under the Insurers' licensing scheme.²¹
80. Different schemes give varying levels of direction, but common factors to be considered include the following (usually these are to be holistically considered, and a decision made based on the exercise of discretion):
- 80.1 evidence of the applicant's good character or reputation;²²
 - 80.2 evidence of previous compliance with regulatory requirements;²³
 - 80.3 mental and physical health, to the extent that it affects the ability to perform the relevant tasks;²⁴
 - 80.4 whether the person has the qualifications and experience reasonably expected for the position,²⁵ and ability to perform the relevant functions;²⁶

²¹ Insurance (Prudential Supervision) Act 2010.

²² Social Workers Registration Act 2003; Lawyers and Conveyancers Act 2006, s 55(a).

²³ Civil Aviation Act 1990.

²⁴ Lawyers and Conveyancers Act 2006, s 55(1)(l).

²⁵ Reserve Bank of New Zealand "Fit and proper standards, Licenced insurers" ; Civil Aviation Act 1990.

²⁶ Social Workers Registration Act 2003.

- 80.5 whether the person has been convicted of an offence in New Zealand or a foreign country; and, if so, the nature of the offence; and the time that has elapsed since the offence was committed; and the person's age when the offence was committed;²⁷
 - 80.6 whether the person has, in any civil proceedings, been found by a court or tribunal to have engaged in an act, omission, or course of conduct that constitutes serious wrongdoing; or aided, abetted, counselled, or procured any other person to engage in an act, omission, or course of conduct that constitutes serious wrongdoing;²⁸
 - 80.7 any overseas disputes or disciplinary actions the applicant has been involved in;²⁹
 - 80.8 whether the person has at any time been declared bankrupt or been a director of a company that has been put into receivership or liquidation;³⁰
 - 80.9 prior involvement in the industry;³¹ and
 - 80.10 any other matter the regulator considers relevant.³²
81. We also consider that there should be an ability by an applicant to appeal an adverse decision.

Option C: Introduce comprehensive lender licencing

82. We acknowledge the potential benefits of comprehensive lender licencing. Licencing could potentially:
- 82.1 allow for the increased visibility of industry participants;
 - 82.2 provide a greater ability to protect borrowers by controlling who is entering the market;
 - 82.3 result in improved compliance by allowing a regulator to assess a lenders' ability to comply before they enter the market;
 - 82.4 offer more compliance tools (ie imposing conditions on licences).
83. However, as discussed above, a comprehensive licencing regime is likely to incur significant compliance and enforcement costs for the regulator and for the industry. We have not attempted to quantify those costs for the purpose of these

²⁷ Lawyers and Conveyancers Act 2008, s 55(c).

²⁸ Reserve Bank of New Zealand "Fit and proper standards, Licenced insurers" at [II.(1)(iii)].

²⁹ Lawyers and Conveyancers Act 2003, s 55(1)(g).

³⁰ Section 55(1)(b).

³¹ Education Act 1989, s 233A(1)(a).

³² Section 233A(1)(h).

submissions. But there will be costs associated with developing systems and undertaking the licencing tasks and we would expect that there would need to be some sort of levy on lenders to fund this activity.

84. As noted above in relation to the application of a fit and proper person test, the review would need to carefully consider evidence supporting the effectiveness of comprehensive licencing in achieving the stated objectives and weigh this against the cost of establishing and administering such a regime. It should compare whether similar impacts could be achieved for less cost through strengthening the law in other ways, such as introducing a fit and proper person test. We have not attempted that comparison for the purpose of these submissions. However, we note that in previous credit reforms licencing was not considered justified:

Given the cost of establishing maintaining and enforcing such a system....strong justification is needed before imposing licencing or registration on an industry. While this case might be made for marginal lenders, it is much less plausible for the remainder of the market.³³

85. While the lending industry has clearly changed and developments in technology may reduce the costs of compliance, we are of the view that the case for comprehensive lending licencing should be carefully assessed. We consider that a licensing regime applying only to some categories of lenders would be more unwieldy and difficult to apply than a general licensing regime.

Options for strengthening enforcement and penalties for irresponsible lending

Enforcement Option A: civil pecuniary penalties, statutory damages and expanded injunction orders for breaches of Lender Responsibility Principles.

Civil Pecuniary Penalties

86. We strongly support the introduction of civil pecuniary penalties, statutory damages, and expanded injunction orders for breaches of the Lender Responsibility Principles. The same or similar remedies should apply to breach of any adopted cap on interest and fees.

Lack of penalties is a problem

87. The current lack of penalties for breaching the Lender Responsibility Principles is problematic and does not assist the Commission in its enforcement activities or in promoting compliance with the CCCFA.

87.1 The lack of a penalty significantly reduces the general and individual deterrent effect of any court proceeding and arguably signals to the community and industry that breaches of the Lender Responsibility Principles are not serious. The lack of penalties provides almost no incentive for lenders

³³ Ministry of Consumer Affairs "Consumer Credit Law Review Part 5 – Redress and Enforcement" ISBN 0-478-24206-9 (October 2000).

to comply with the Lender Responsibility Principles. We consider it possible that a number of the borrower harms identified in the Discussion Paper could be substantially avoided or addressed through the simple introduction of available penalties for breaches of the Lender Responsibility Principles.

- 87.2 We believe that the Commission achieved a real impact in the mobile trader industry through prosecutions of disclosure breaches. We prosecuted 13 mobile traders between February 2016 and 26 April 2018 and obtained fines totalling \$1.56 million. If there were more prescriptive requirements for Responsible Lending, and penalties were available for breaches, the Commission may be able to have a similar impact in driving compliance, public awareness and remediation of harms.
- 87.3 Current remedial provisions are insufficient. For there to be any financial consequence for a lender for breaching the Lender Responsibility Principles the Commission must be empowered to seek orders for appropriate penalties and compensation for borrowers.

The case for civil pecuniary penalties

88. We support the introduction of pecuniary penalties for breaches of the Lender Responsibility Principles (and other significant breaches of the Act, such as the fee provisions if they remain without amendment). In our view, civil pecuniary penalties are likely to make the Commission's enforcement of the CCCFA more efficient and effective.
- 88.1 Civil pecuniary penalties are consistent with remedies available to the Commission under other legislation and in other jurisdictions. Pecuniary penalties are available in New Zealand in the Commerce Act 1986 and Financial Markets Conduct Act 2013. They are available in Australia for breaches of credit laws and are used effectively by ASIC.³⁴ We have submitted to Government that we would also welcome their availability under the Fair Trading Act 1986.
- 88.2 Civil pecuniary penalties would create efficiencies by reducing the need for the Commission to take criminal and civil proceedings in relation to the same conduct. It is not always straightforward for the Commission to take proceedings for compensation orders following conviction in criminal proceedings. Difficulties arise particularly where the amount of compensation

³⁴ ASIC's penalties were reviewed in 2017. The Government in the *ASIC Enforcement Review: Positions Paper 7 – Strengthening Penalties for Corporate and Financial Sector Misconduct* (October 2017) considered that even with a maximum penalty of \$420,000 for an individual and \$2.1m for a company under the National Consumer Credit Protection Act 2009 “the maximum civil penalties ... should be increased to ensure that ASIC can seek and the courts are empowered to impose penalties that: reflect community perceptions of the seriousness of engaging in ... misconduct and expectations as to the associated consequences”.

sought is high³⁵ and/or where there is a large pool of affected borrowers. To overcome these difficulties the Commission has, from time to time, initiated concurrent but separate civil and criminal proceedings, which have generally been slow to progress.

- 88.3 The Commission frequently has to make choices about the form of proceedings it take. In making those decisions we take into account resourcing requirements, the efficiency of one form of proceedings over another in any particular case and we weigh considerations such as the primacy of obtaining compensation as against obtaining a penalty sanction. Introducing civil pecuniary penalties would mean that the Commission would be able to obtain both compensation and a penalty in one set of proceedings.
- 88.4 Civil pecuniary penalties are considered to be a legitimate regulatory tool by the Law Commission.³⁶ Taking into account the findings of the Law Commission’s report, the CCCFA regime and the finance industry have a number of features that would make civil pecuniary penalties appropriate:
- 88.4.1 Most lenders that are the subject of our enforcement outcomes are incorporated companies and not individuals, and accordingly do not necessarily require the protections offered by criminal law to individual defendants. In the enforcement outcomes currently recorded on our Enforcement Response Register relating to the CCCFA since 2015, 31 outcomes have involved incorporated companies, only four outcomes have involved individuals.
- 88.4.2 The CCCFA imposes many requirements on lenders. We would expect them to have a high degree of regulatory knowledge and have access to resources to protect themselves against the risk of liability.
- 88.4.3 Civil pecuniary penalties are justified in our view given the potential harm caused to vulnerable borrowers and the need to deter irresponsible lending.
89. Civil pecuniary penalties also lend themselves to settlements which, in themselves, create enforcement efficiencies. As we have previously submitted to MBIE, our ability to settle would also be enhanced if the CCCFA gave the Commission the ability to accept enforceable undertakings, as is the case under the Fair Trading Act 1986.³⁷
90. The question about whether breaches of the Lender Responsibility Principles are suitable for civil or criminal proceedings is a policy one.

³⁵ And therefore either outside the District Courts’ monetary jurisdiction or at a level that the District Court is not accustomed to awarding.

³⁶ Law Commission “Pecuniary Penalties: Guidance for Legislative Design” Report 133 (August 2014).

³⁷ For example Commerce Commission “Letter to Hon Kris Faafoi” (15 December 2017).

- 90.1 We agree that the civil standard of proof may be more appropriate for principles based duties such as lender responsibilities.
- 90.2 However, if pecuniary penalties are not adopted for breaches of the Lender Responsibility Principles we support making breach a criminal offence, with fines available to be imposed. We do not support a continuation of the current penalty vacuum for breaches of Lender Responsibility Principles.
91. We also recommend that the review consider whether breaches of the Lender Responsibility Principles should be subject to criminal sanction as well as pecuniary penalties. There are likely to be egregious cases where a criminal sanction would be desirable. A choice of enforcement outcome as between civil and criminal provides the Commission with flexibility in the exercise of its enforcement discretion to achieve the most appropriate outcomes for affected borrowers and in the public interest.³⁸

Design features of pecuniary penalty regime

92. In designing any pecuniary penalty regime we suggest:
- 92.1 the Act specifically provides that statutory damages and orders for compensation take precedence over civil pecuniary penalties where a lender does not have sufficient resources to pay both; and
- 92.2 that regard is given to which court has jurisdiction to order pecuniary penalties.

Statutory Damages

93. We support the introduction of statutory damages for breaches of the Lender Responsibility Principles. Statutory damages would create efficiencies for the Commission by quantifying amounts payable to affected borrowers without having to establish loss or damage for individual borrowers. The availability of statutory damages may also make it easier for individual borrowers or their advocates to take direct action without assistance from the Commission.
94. Statutory damages in themselves are likely to provide some general and individual deterrent effect for lenders who breach the Lender Responsibility Principles. Where breaches of the Principles can be established across a loan book (for example a systemic failure to make any inquiries about a borrowers' income) the financial consequence of statutory damages for a lender could be significant.
95. There would be benefit in enabling the Commission to obtain some remediation for borrowers without requiring proof of loss or damage. Currently the Commission is required to prove loss or damage for borrowers affected by breach of the Lender Responsibility Principles and establish for those borrowers:

³⁸ See Commerce Commission "Enforcement Response Guidelines" (1 October 2013) at 11.

- 95.1 that the lender had breached the Principles;
 - 95.2 that the borrower had suffered loss; and
 - 95.3 that the lenders' conduct was an operative cause of the borrower's loss.
96. The Commission then has to quantify the borrowers' loss. Where borrowers have had the benefit of a loan this is not necessarily straightforward. Often the number of affected borrowers makes this exercise difficult and time consuming or, at worst, prohibitive.
97. It would promote efficient enforcement of the CCCFA to provide statutory damages for breaches of the Lender Responsibility Principles but to preserve the ability for borrowers (or others) to take action if they have suffered loss or damage above that level. If statutory damages were introduced for breaches of the Lender Responsibility Principles they should be supported by a statutory ability for the Commission to accept enforceable undertakings providing for the payment of an equivalent amount by a lender without the need to obtain a court order to that effect.

Design of statutory damages

98. Provision for statutory damages could utilise the existing provision in subpart 2 of part 4 of the CCCFA including the ability to reduce statutory damages under s91 and s92. .
99. We also recommend clarifying the relationship between the remedial provisions contained in the CCCFA.³⁹ It will be particularly important not to introduce any new statutory damages provisions without clear articulation of their relationship to existing remedial provisions.
100. The Commission agrees that setting the measure of statutory damages at the level of the interest and fees paid (or payable) under the loan (i.e. costs of borrowing) is appropriate for breaches of the "suitability" and "affordability" Lender Responsibility Principles (ss 9C(3)(a)(i) and (ii)). Where these requirements are breached the loan should not have been entered into, and the borrower should be put in the same position as if the loan had not been made. We consider that the sum to be paid should be a minimum of \$200 in order to ensure that there are appropriate consequences for high-cost lenders, where the costs of borrowing may not be high but borrowers have nevertheless suffered financial hardship.

³⁹ There is no hierarchy of remedies and breaches are not treated consistently within the Act. Statutory damages pursuant to s 89 and costs of borrowing pursuant to s 99(1A) and compensation orders are all available for breaches of s 17 and s 22. Lenders are required to disgorge costs of borrowing for a breach of s 17 and 22 but they are "infringement" offences subject only to a maximum penalty of \$30,000, for a company. A breach of the disclosure standards, however, is an offence with a maximum penalty of \$600,000.

101. For breaches of the other Lender Responsibility Principles, the Commission suggests that the CCCFA default measure of statutory damages is based on a percentage of the credit limit or total advances made, with a minimum of \$200 (ss 89(1)(d), 89(3)), as the specific harm caused by such breaches is otherwise hard to quantify.
102. There is currently some ambiguity about the courts' expected approach to the award of statutory damages. We recommend where possible that this uncertainty is addressed through specific provisions:
- 102.1 It is not clear whether the Commission is required to identify all affected borrowers when seeking orders for statutory damages. In some of our disclosure prosecutions the courts have awarded statutory damages to identified borrowers who received deficient disclosure.⁴⁰ In other cases the courts have been prepared to order refunds of costs of borrowing for all borrowers including unidentified borrowers.⁴¹
- 102.2 It is not clear how the court will approach an application by a lender to reduce the amount of statutory damages payable if it is "just and equitable to do so".
- 102.3 As noted above, in our view, it is important that the Act provides that statutory damages take precedence over civil pecuniary penalties where a lender does not have sufficient resources to pay both, so that borrowers' compensation is prioritised.

Mandatory Injunctions

103. We support the introduction of mandatory injunctions. Mandatory injunctions are likely to provide a useful tool to enable us to effectively obtain compliance with the CCCFA particularly for breaches of the Lender Responsibility Principles.
104. Prohibitive injunctive relief is currently available as a remedy but has limitations. Generally it does little more than emphasise that lenders must not breach the provisions of the Act. There is limited value in obtaining injunctions that simply particularise the conduct that constitutes a breach of the relevant provisions, particularly where the conduct is already subject to a criminal penalty. By the time we have ascertained that the lender has engaged in contravening conduct we are generally able to take criminal proceedings. Most lenders cease or change their conduct after the Commission commences an investigation.

⁴⁰ In *Commerce Commission v Mobile Shop Limited* [2018] NZDC 8471, the Court awarded statutory damages to 54 customers; statutory damages were also awarded in *Commerce Commission v Flexi Buy Ltd* DC Auckland [2016] NZDC 3028.

⁴¹ *Commerce Commission v Macful International Limited* [2017] NZDC 18615; *Commerce Commission v Apperture Marketing Ltd Limited (in liquidation)* [2018] NZDC 1853; sentencing notes both referred to debtors who entered into contracts between certain dates.

105. Mandatory injunctions would enable the Commission to require lenders to take positive steps to comply with the Principles, or to take such other steps as the court considered necessary in the circumstances. For example it would enable the court to direct that a lender must take such steps as:
- 105.1 Obtaining and scrutinising bank statements from a borrower before entering into a loan;
 - 105.2 Including a warning in advertising of high-cost loans; or
 - 105.3 Advising a borrower if lower cost loan types might be elsewhere available.
106. Injunctions or orders of this nature are available to ASIC in Australia. Section 177 of the National Consumer Credit Protection Act 2009 gives the Court powers to **require** a person act on such terms as the Court thinks is appropriate.

Stop orders

107. The Additional Information Paper asked for feedback about whether Stop and Direction orders would be useful enforcement tools. We do not think that these enforcement tools are necessary. We are comfortable with the current regime, particularly if we were able to obtain mandatory injunctive relief.
108. Currently, if a lender is engaging in conduct that we consider breaches the CCCFA, and we think that the conduct needs to cease in order to prevent further consumer harm, we will send a “stop now” letter. Their purpose is explained in our publicly available Enforcement Response Guidelines. They can serve as a letter before action seeking an injunction and these letters outline our concerns and request that the lender stops the relevant conduct. From our experience these letters have mostly proven effective. If a lender refused to comply with our request, we could seek an injunction from the Court.
109. We think it is appropriate that it is the courts that are empowered to prevent a lender from engaging in conduct which breaches the Act. If a lender chooses not to comply, it is likely because they consider they are acting legally. Prohibiting a lender from engaging in conduct which breaches the CCCFA necessarily involves adjudication on the law, which is the role of the judiciary. Recourse to the courts ensures that the Commission asks the right questions when interpreting the Act and considering whether a lender has breached the Act.⁴²

Enforcement Option B: director duties

110. The extent to which directors and senior managers should have statutory duties relating to a creditor’s compliance with the CCCFA is a matter of policy. We are not in

⁴² David Goddard, QC “Regulatory Error: Review and Appeal Rights”(paper presented to Legal Research Foundation Conference, Auckland, September 2006).

a position to comment on the likely costs or benefits of different kinds of individual liability for breaches of the CCCFA.

111. However, we note that where a lender company is small, and there is clear involvement by a director in a breach, they can already be held liable as a party to the proceeding.⁴³ The review should consider whether, beyond this, it is appropriate for directors of large lenders and persons who hold governance positions, to be held liable in some way related to the lender's breach of the CCCFA.
112. We also note that there will be additional enforcement costs associated with enforcing director's duties which will have resourcing implications for the Commission.

Design of directors duties

113. If director's duties are adopted we have some comments on the formulation of any duties imposed on directors.
114. If statutory duties are to be effective, they should attach to those persons (including senior managers) who are involved in making important strategic and operational decisions for the lender.
115. We support provisions that make directors (and senior managers) strictly liable for a company's contravention but which provide defences where a director (or senior manager) had taken reasonable and proper steps to ensure compliance. In our view, this approach best reflects:
- 115.1 the need for directors to ensure that there are sufficient systems in place to ensure compliance; and
- 115.2 that the directors (or senior managers) themselves are in the best position to demonstrate what steps they have taken.
116. If directors' duties are imposed we would recommend that the extent of those duties is explicit and, if the responsibilities are to differ depending on the role of individual, that each set of duties is described. To the extent that it is suggested in the Discussion Paper, we do not support provision for a set of duties that are scalable dependant on the scope of the individual's role. We consider this will create ambiguity and possible enforcement difficulties for the Commission.
117. If the duty requires that directors must ensure, as far as reasonably practicable, that the creditor complies with its obligations under the CCCFA, it may be beneficial to have the meaning of "reasonably practicable" defined in the Act. This is the case in the Health and Safety at Work Act 2015, which incorporates similar duties.

⁴³ Commerce Commission "Enforcement Response Guidelines" (1 October 2013) at [20 to [24]. set out the circumstances in which we will consider taking action against individuals.

118. We also suggest that a breach of directors' duties should be grounds for a banning order under s 108. The inclusion of directors' duties would enable a court to ban a director under s 108 where they had breached their duties twice⁴⁴ without a director needing to be party to the proceedings in relation to the original breach of the Act. If directors' duties are introduced, consideration should be given to whether a single breach of directors' duties should give rise to the ability to obtain banning orders. This would be consistent with s 108(1)(a)(i), which provides a director can be banned if a creditor is convicted of a single offence under the Act. We discuss these matters above in relation to the provision for banning orders.

Enforcement Option C: substantiation obligations for lenders (Lender Responsibility Principles)

119. We strongly support the introduction of an offence of a failure to substantiate an appropriate loan affordability and suitability assessment. We discuss the value of a substantiation offence later in this submission in relation to the reasonableness of fees. We note:
- 119.1 Enforcement Option C will assist our enforcement of the Lender Responsibility Principles. It will assist us to take enforcement action against lenders who cannot produce evidence of their affordability assessments - particularly those who have not made any inquiries about a borrowers' ability to repay the loan – without any need to prove:
- 119.1.1 whether the lender has made inquiries and whether they were reasonable; and
- 119.1.2 whether the lender could have been reasonably satisfied that the borrower could make payments.
- 119.2 Breach of the Lender Responsibility Principles themselves would continue to constitute a separate and additional offence which the Commission could pursue in suitable cases.
- 119.3 This enforcement option will also assist borrowers to take their own action. We understand that borrowers and their advocates currently find it difficult to obtain information from lenders about what inquiries and assessments were made. If lenders are not able, on request, to provide evidence that they have made reasonable inquiries and how they have assessed all the information available to them then this option would allow borrowers to take their own action in the Disputes Tribunal.
120. If this option was adopted we see no reason why it should not apply to all lenders who are subject to the Lender Responsibility Principles. All lenders are required to make inquiries and undertake an assessment. It would not appear to impose an

⁴⁴ CCCFA, s 108(1)(a)(v).

unreasonable additional compliance cost to require lenders to provide evidence of those inquiries and assessments on request.

Enforcement Option D: Introduce industry levy to fund enforcement.

121. We support this proposal to the extent that it would provide additional funding for the Commission's enforcement activities. We note that the current registration levy for lenders (providing credit under credit contracts) is paid to the Financial Markets Authority .
122. Depending on which, if any, proposals set out in the Discussion Paper are adopted we would expect that our enforcement activities would increase. For example we are likely to incur additional costs in:
- 122.1 enforcing any interest rate cap option;
 - 122.2 taking more enforcement action in relation to advertising and affordability assessments; and
 - 122.3 enforcing against traders selling goods on deferred payment terms in excess of the market price of goods; and
 - 122.4 providing guidance about and enforcing provisions that require debt collectors to provide an affordable repayment plan.

Enforcement Option E: Introduce requirement for lenders to work with consumer advocates if asked to do so and in good faith.

123. We support this proposal. We understand that advocates face challenges in dealing with some lenders where lenders' policies are strict and flexibility is limited, such as can be the case with the banks and larger finance companies. For example, advocates find working with the banks difficult when loans such as credit card arrears have built up and are due to go to a debt collector (which adds further costs for their clients). They encounter difficulty agreeing on an affordable repayment plan or to stop the loan going to the debt collector. Advocates also find it frustrating when the client has given consent for the advocate to work with the lender but the lender insists on dealing directly with the client. Advocates report that their clients are often in no position to effectively negotiate a repayment plan with the lender. Often advocates find their clients have agreed to unaffordable repayment plans for arrears and have made promises to lenders that they cannot keep. The introduction of this requirement could assist borrowers, their agents and lenders by formalising the nature of the permitted relationship between them as well as casting a positive obligation upon lenders who might otherwise be reluctant to deal with budget advisers.

Options for introducing more prescriptive requirements for affordability assessments and advertising.

General Comments - Affordability assessments

124. It is apparent from our responsible lending investigations to date that lenders make differing levels of inquiries and take very different approaches to affordability assessments.
125. All of the high-cost short-term lenders we contacted in our 2016 High-Cost Credit Review indicated that they obtained bank statements from prospective borrowers and it appears that they rely on these statements (and information from borrowers) to establish the level of a borrowers' income. Only one lender indicated that they routinely verified borrowers' income by calling their employer.⁴⁵
126. Most also indicated that they relied exclusively on information provided by borrowers' and bank statements to identify the borrowers' expenses and whether the borrower has other financial commitments. Four of the nine lenders indicated that they regularly undertook credit checks on customers.⁴⁶
127. In our experience it is less clear how mobile traders and motor vehicle dealers who offer finance undertake affordability assessments. The information we have obtained in the course of our investigations suggests that motor vehicle dealers (providing finance) do not routinely obtain bank statements and they regularly rely on information provided by the customer to a sales representative or dealer.
128. Some mobile traders have told us they do ask for bank statements but we saw no evidence of this on borrower files we obtained from those traders. Some mobile traders have told us that they do not seek bank statements at all. There is evidence that the sales representatives or dealers do not ask for, or do not record, complete information or that the information that is recorded does not reflect the borrowers' actual financial position.

In March 2018 the Commerce Commission warned Dealer Finance for breaches of the Lender Responsibility Principles through its agent Nigel Thompson Motor Company Limited (NTMC) in relation to affordability assessments conducted by NTMC.

The Commission noted in its warning that in the three loans it had considered NTMC had only obtained a current bank statement in relation to one loan and it appeared that it had not been properly considered when the loan was approved.

⁴⁵ Another lender indicated that the loan contract authorised them to contact the borrowers' employer but that they did this on a case by case basis.

⁴⁶ Another lender said that they undertook credit checks "where appropriate". A number of lenders indicated that they performed an Insolvency and Summary Instalment Order check.

129. We are also aware that lenders are making different types and depths of assessment assessments about the borrowers' ability to pay. Some lenders use short-cut assumptions to assist their assessment. For example we are aware of lenders that make limited inquiries into the borrowers' expenses and simply employ (different) protected income ratios and debt servicing ratios in assessing loans. For example we are aware of a lender that requires that payments under the loan must be equal to or less than 40% of the borrowers' after tax income per pay period and all debt repayments must not exceed 48% of that amount. We are aware of other lenders that do not employ protected income ratios at all and will approve a loan application where the borrowers' expenses and loan repayments are the same as the borrowers' income.
130. Repeat borrowing is also problematic and we have evidence that many lenders do not undertake a full affordability assessment when issuing loans to existing customers.
- 130.1 Some lenders indicate that they require repeat borrowers to provide a current bank statement only if they have not borrowed for a three month period, if they have defaulted on a previous loan, or if their circumstances have changed.
- 130.2 Some lenders rely (to some extent) on confirmation (self-assessment) from borrowers that they can afford the loan without substantial hardship.

Responsibility Option A: introduce more prescriptive requirements for affordability assessments.

131. We strongly support this proposal.
- 131.1 In general more prescriptive requirements provide certainty and are easier to comply with and easier to enforce.
- 131.2 In our view it is possible to set minimum prescriptive requirements for affordability assessments without compromising lenders' need to have flexibility to make assessment that they consider essential (if not across the industry then at least in parts of it).
132. In relation to the particular proposal set out at paragraph [280] of the Additional Information Paper we note:
- 132.1 We consider that it is important for lenders to take into account the fact that borrowers may have irregular income (for example where employment is seasonal or casual) or that their future income is uncertain (for example where borrowers have probationary or temporary employment). We are concerned that this information is not always apparent from a consideration of snapshot bank statements alone.

- 132.2 There is a risk that relying entirely on bank statements to identify other financial commitments will not be sufficient, particularly if the borrower has other loans that are in default and payments are not recorded.
133. Careful consideration would need to be given to setting a minimum allowance for living expenses and a minimum monthly surplus. We are aware of one lender who approves loans where, based on its affordability assessment, the borrower has no uncommitted cash each month (there is no buffer or margin for error).
- 133.1 The proposal would need to consider whether lenders would be required to undertake a new affordability assessment for returning borrowers.
134. In our view any prescriptive affordability assessments should, at least, apply to high-cost lenders, traders offering credit sales and motor vehicle dealers. But we see no reason that they should not apply to all lenders.

Verification of information provided by borrowers

135. We support a requirement that lenders verify some information provided by borrowers, particularly where that information is easily obtainable.
136. Currently, lenders are able to rely on information provided by borrowers unless they have reasonable grounds for believing the information is not reliable. These provisions undermine our ability to take action in relation to inaccurate or poorly completed affordability assessments.
137. We have received complaints about affordability assessments where the lender is alleged to have taken incorrect information into account in assessing the borrowers' income or expenditure. Where lenders claim that the incorrect information has come from the borrower we are unable to take any enforcement action unless we can be satisfied that the lender "knew or should have known" that the information was inaccurate. This requires an analysis of what the borrower told the lender and an assessment of the respective parties' reliability.

Dorchester Finance Limited

In April 2018 we issued a compliance advice letter to Dorchester Finance Limited (Dorchester). Dorchester had approved a \$20,000 loan to Borrower B for a motor vehicle taking into account unverified income from the borrowers' partner. Borrower B had a loan from another finance company and had received eight banks loans from \$1,000 to \$25,000 within the last two years.

Had Dorchester sought verification of the partner's income, the loan would not have been granted.

Lender D

We recently investigated a lender who had approved a loan to a borrower without allowing for any expenses for rent in its affordability assessment. The lender alleged that the borrower had said that he paid for the household groceries and that his partner paid the rent. The lender took no further steps to verify the information provided by the borrower.

General Comments - Advertising

138. We do not think that the current provisions of the Lender Responsibility Principles relating to advertising are sufficiently prescriptive to ensure compliance in the manner intended. In addition, there are no penalties relating to breaches of the Lender Responsibility Principles and we would be unlikely to prove loss or damage caused by irresponsible advertising. In effect, the only tool available to the Commission to enforce the advertising provisions of the CCCFA is to seek prohibitive injunctive relief.
139. The current lack of statutory prescription for irresponsible advertising combined with lack of penalties leaves open the suggestion that Parliament considered breaches of these provisions to be less serious. We have nevertheless alleged breaches of the advertising requirements alongside allegations of other breaches of the Lender Responsibility Principles in our proceedings against Ferratum New Zealand Limited.
140. The Lender Responsibility Principles relating to advertising are not prescriptive; simply requiring lenders "act with the care, diligence and skill of a responsible lender"⁴⁷ and to ensure that advertising is "not, or is not likely to be, misleading deceptive or confusing to borrowers".⁴⁸ It is not mandatory for high-cost lenders to include the warning referred to at paragraph [3.6] of the Responsible Lending Code. There is no requirement for lenders to advertise their annual interest rate (other than to display it on their website as part of its costs of borrowing).

⁴⁷ CCCFA, s 9C(2)(a)(i).

⁴⁸ Section 9C(3)(b)(i).

141. Lenders are increasingly advertising loans using different media including on social media and by direct advertising to existing borrowers through e-mail and text message. We have evidence of high-cost lenders encouraging borrowers to reapply for loans via text, including when borrowers are in default on their current loans. An example of a text from a high-cost lender to a defaulting borrower reads:

We strongly recommend you pay your outstanding loan fully and as fast as possible to avoid default fees and default interest. You can either make cash deposit or internet banking as per to your convenience. If you [sic] in urgent need to cash, you can simply make your full repayment and may also re-apply for a bigger loan.

You can always immediately re-apply for your next loan by logging on to MY ACCOUNT or by sending TXT.

142. We are also aware that some lenders continue to directly advertise to borrowers even after they have indicated that they no longer wish to receive direct advertising. While the Unsolicited Electronic Messages Act 2007 may offer some protection, we suspect consumers are likely to be unaware of their rights under that Act and/or are unlikely to exercise them.

Responsibility Option B: introduce more prescriptive requirements for advertising.

We spoke to a borrower in the course of one of our investigations who had just paid off a high cost loan and had received a text from the lender offering more credit. The borrower texted “stop” but more texts followed. He told us he tried to opt out a second time but eventually applied for a new loan following further texts offering more credit.

143. We support a proposal to introduce more prescriptive requirements for advertising combined with greater penalties for breaching the Lender Responsibility Principles as set out in Enforcement Option A (that is, the introduction of statutory damages, mandatory injunctive powers and pecuniary penalties).

143.1 In general, more prescriptive requirements provide certainty and are easier to comply with and easier to enforce.

143.2 If this proposal is adopted, and the Responsible Lending Code’s provisions on advertising were made mandatory, we also recommend considering whether the current guidance in the Responsible Lending Code should be modified to:

143.2.1 specifically capture direct advertising to borrowers;

143.2.2 prohibit direct advertising to borrowers that are in default or have recently defaulted on a high-cost loan;

143.2.3 prohibit repeated direct advertising of high-cost credit agreements to borrowers.

- 143.2.4 prohibit direct advertising by any means to borrowers who have requested in writing not to receive further offers of credit.

Responsibility Option C: Introduce requirement that disclosure is made in the same language as advertising.

144. We support this proposal to the extent that it will assist a lender's target market to understand the terms of their loans.

Issue 3 Continued predatory behaviour by mobile traders

13

Do you agree with our assessment of the costs and benefits of the options for covering additional credit contracts under the CCCFA? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?

14

Do you have any suggestions for the design of options for covering additional credit contracts under the CCCFA? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?

15

Which options for changes to cover additional credit contracts would you support? Which would you not support? Please explain how you made your assessment.

145. We are aware that mobile traders are selling goods door to door to vulnerable consumers using high pressure sales tactics. We are also concerned that, because of the way the transactions are disclosed consumers are not able to compare costs across competing products.
146. The concern identified by the Discussion Paper relates to traders selling goods by deferred payment at prices which greatly exceed the price that the same, or comparable goods, might be available in alternative retail outlets.⁴⁹ There is evidence that these types of transactions are causing significant consumer harm among vulnerable and disadvantaged consumers both because of the price they are paying for the goods and because of their commitment to deferred payment terms.

We investigated Trader A that offered the following goods for sale by way of deferred payment. It did not charge interest or fees. We found the same goods for sale elsewhere at substantially lower prices:

Item	Advertised price	Price elsewhere
Robot vacuum cleaner	\$2,000	\$100
Smart watch	\$499	\$35
Virtual reality glasses	\$300	\$20

⁴⁹ These products are similar to “tiny terms products” prevalent in Australia in the late 1990’s. The Ministerial Counsel on Consumer Affairs particularly considered reform of the Uniform Consumer Credit Code to deal with these transactions in its Uniform Consumer Credit Code: Post Implementation Review 1999 at 53.

147. The deferred sale of goods transactions offered by mobile traders can meet the definition of a layby sale agreement in the Fair Trading Act 1986. Or if traders charge interest or credit fees (other than a cancellation fee) they can, at the same time, meet the definition of a consumer credit contract. By charging high prices and not selling the goods for cash up-front, many traders avoid disclosing what is, in effect, a cost of borrowing. Where they do not charge credit fees they avoid regulation under the CCCFA entirely.
148. The overlap between the application of the layby sales and CCCFA provisions creates enforcement and compliance difficulties. We have communicated our view on these problems below.
149. In addition, both the CCCFA and layby sale provisions have inherent limitations:
 - 149.1 Where the trader treats the transaction as a consumer credit contract, the borrower has a limited time to cancel the contract and the trader does not disclose the difference between a comparable market price and the price payable under the contract particularly where the trader does not themselves sell the goods for cash up-front. For example, a mobile trader that has “one price” for the goods but does not ever sell them for cash will simply disclose that price as the cash price of the goods even where it is two or three times the price that the same or similar goods could be obtained at another retailer. While the difference between the two prices can be thought of as an implicit cost of credit, this is not disclosed to the consumer. The consumer is unable to compare the cost of obtaining the same, or similar, items elsewhere for a cheaper price and/or on different credit terms.
 - 149.2 Where the trader treats the transaction as a layby sale agreement it does not undertake any affordability assessments and the consumer has no right to make a hardship application although they are required to keep making payments by instalment after they have taken possession of the goods. In some cases this can have the effect of tying consumers into lengthy contracts that they cannot afford. We also have evidence that consumers are charged very high cancellation fees.

In August 2016 Consumer B signed a contract with Trader B to purchase a Home Entertainment Combo (including a TV, laptop, home theatre and phone) for \$3,494.50 with payments of \$44.80 per week for 78 weeks.

The goods were to be delivered after 23 payments.

Between September and March Consumer B made 18 payments on her contract but missed 12. She paid \$806.40 in total. Eventually Consumer B cancelled the contract. Trader B charged her cancellation fees of \$655.77. Consumer B did not receive the goods.

150. Almost all of the mobile traders that have come to the attention of the Commission do not charge interest. Of the 17 mobile traders we reviewed in our 2015 Mobile Trader Project⁵⁰ that sold goods by way of deferred payment:
- 150.1 Almost all were selling goods on deferred payment terms at a total cost to the consumer that significantly exceeds the price paid at alternative retail outlets;
 - 150.2 Only two charged interest;
 - 150.3 Six charged relatively small establishment or administration fees (other than cancellation fees);
 - 150.4 Thirteen of these arrangements met the definition of a layby sale agreement⁵¹ and seven also met the definition of a consumer credit contract (meaning that the trader was required to comply with both statutes).⁵²
 - 150.4.1 Of the traders that offered arrangements that met the definition of a layby sale agreement, four did not charge interest or credit fees other than a cancellation fee and were treated as layby sale agreements subject under s36B(4) of the Fair Trading Act. All four traders took a security interest in the goods.
 - 150.4.2 Two traders offered arrangements that did not appear to meet the definition of a consumer credit contract or layby sale. The consumer took delivery at point of sale, no interest or fees were charged and the trader did not take a security interest.
151. Examples we have seen in the course of our investigations include:

⁵⁰ Of the original 32 traders are still trading.

⁵¹ Fair Trading Act 1986, s 36B.

⁵² Four are subject to the exemption in s 36B(4) and are only treated as laybys.

- 151.1 A trader sold highly priced goods, door-to-door on deferred payment terms. Customers received goods after making approximately 25 minimum number of payments required for delivery. Additional payments were required to pay for the goods in full (typically a further 53 payments). If the customer missed a payment the contract provided that the minimum payments required for delivery increased in accordance with a prescribed schedule contained in the contract. So that if the customer missed one payment, the goods were delivered after 32 weeks instead of 25, if the customer missed two payments the goods were delivered after 40 weeks. A large number of customers were missing payments and facing the choice of:
- 151.1.1 paying high weekly payments without having received any goods;
or
 - 151.1.2 paying what in many cases what was a prohibitively high cancellation fee.
- 151.2 Traders signing up consumers to deferred payment sales of consumer goods following telephone sales calls where the customer did not agree to purchase the goods.
- 151.3 Traders collecting very long dated debts for consumer goods.
- 151.4 Traders using multiple direct debit authorities and using them as a method of debt collection.
152. The evidence suggests that the consumer harm reportedly experienced with mobile trading is enduring and may require bespoke policy consideration and regulation. We consider that it may be difficult to amend the CCCFA in its current form to easily accommodate the regulation of goods sold at prices significantly higher than those available for the same or similar goods at alternative retail outlets. The price of those transactions can be said to include a cost of credit but identifying the cost of credit and defining appropriate requirements for its disclosure is challenging. Below we note some of those challenges in relation to the options proposed in the Discussion Paper.

Scope Option A: include credit contracts that charge default fees in the definition of consumer credit contract.

153. We do not favour this option because of the potential for regulatory over-reach.
154. We do not have evidence of consumer harm caused by transactions like those offered by providers such as Afterpay NZ Limited or LayBuy Limited at this time. If regulation is required, we suggest that they could be subject to separate treatment under the CCCFA so as to avoid altering the existing definition of a 'consumer credit contract'. Consideration could then be given to the CCCFA obligations that should apply to traders offering these services.

155. This amendment may also capture arrangements for deferred payment for services such as utilities contracts or contracts for medical or education services where:
- 155.1 there is no consideration charged for deferring the debt; and
 - 155.2 the transactions are not intended to be considered credit contracts.
156. In our view it is not appropriate for traders offering these services to be required to comply with the requirements of the CCCFA, for example, by providing disclosure or complying with the Lender Responsibility Principles.

Scope Option B: Prohibit the price of goods or services sold on credit from exceeding the cash price

157. We support a clear demarcation between layby sales agreements and consumer credit contracts and the regulatory framework that applies to each. We also consider that they may best be regulated through a more fulsome policy review than is proposed in the Discussion Paper. For example, other possibilities that could be considered include whether mobile traders should be:
- 157.1 subject to a cost of credit cap or be regulated by an unconscionable conduct trading prohibition in the Fair Trading Act; or
 - 157.2 prohibited from:
 - 157.2.1 selling goods for more than a specified percentage above the wholesale price from which they obtained the goods;
 - 157.2.2 entering into uninvited direct sales; or
 - 157.2.3 advertising their services/goods at all, or using particular methods or advertising channels (for example similar to limitations on cigarette or alcohol advertising).
158. If the review considers that reform of the CCCFA is required in this area we suggest:
- 158.1 The Fair Trading Act and CCCFA are amended to ensure that there is no overlap between the definition of layby sales and a credit sale of goods and the jurisdictions of the Fair Trading Act and the CCCFA are clearly delineated.
 - 158.2 The CCCFA is clear that the credit sale of goods by way of deferred payment is subject to the CCCFA.
 - 158.3 Schedule 1 is amended to explicitly state, for the credit sales of goods:
 - 158.3.1 traders are required to disclose the cash price of goods; and

- 158.3.2 the difference between the cash price and financed price is explicitly treated as either interest or a credit fee (and is required to be disclosed).
- 158.4 The definition of “cash price” should be amended to make it clear that the first limb of the definition (the price at which the lender would sell goods for cash at the time the contract was entered into) applies only where the lender **actually** sells goods for cash up-front.⁵³ If the trader has not actually sold the goods for cash up-front, the cash price should be the fair market value of the goods. Where the transaction is covered by the CCCFA (the trader charges a credit fee) it is unclear whether lenders are required to disclose the cash price of the goods and what “price” they are required to disclose: for example what should be disclosed where the lender has just one price for the goods but does not actually sell them for cash.
- 158.5 If there is to be a comparison rate the cash price differential should be included in that rate.
- 158.6 We also recommend that these transactions should be subject to a cost of credit cap where they are provided on similar terms to high-cost credit agreements (or subject to the industry-wide interest rate cap if one is adopted).
159. Scope Option B or amendments to the definition of “cash price” may assist the Commission in taking enforcement action that would address the harm referred to in paragraph [317] of the Discussion Paper for goods which are:
- 159.1 commonly sold at retail; and
- 159.2 have a readily ascertainable market value.
160. It is less clear how a lender or the Commission would be able to ascertain the “cash price” of unique goods (such as clothing made overseas and not available at any other retail outlet) or goods that have a fluctuating value (such as nappies or meat products). Determining the fair market value or cash price of those goods will be difficult and time consuming, if not impossible.

Unconscionable conduct

161. Regulation of the mobile trader industry would be significantly assisted by an unconscionable conduct provision, either in the Fair Trading Act 1986 or in the CCCFA. There is currently no general provision in New Zealand’s consumer

⁵³ The Australian National Consumer Credit Protection Act 2009 defines cash price as (a) the lowest price that a cash purchaser might reasonably be expected to pay for them from the supplier; or (b) if the goods or services are not available for cash from the supplier or are only available for cash at the same, or a reasonably similar price to the price that would be payable for them if they were sold with credit provided – the market value of the goods.

protection legislation prohibiting conduct that is clearly unfair and unreasonable. In 2012, the Commission submitted in favour of a prohibition against unconscionable conduct in the review of consumer law.

162. For many years, Australia's consumer protection legislation has contained provisions that relate to unconscionable conduct for fair trading and consumer credit.⁵⁴ In 2015, ASIC took enforcement actions against payday lender Cash Store Pty Limited. Penalties were imposed of almost A\$19 million for irresponsible lending and unconscionable conduct.⁵⁵
163. We are aware of conduct in the mobile trader industry that could be addressed by a prohibition on unconscionable conduct.

⁵⁴ Australian Securities and Investments Commission Act 2001 (Cth), subdivision C and Competition and Consumer Act 2010 (Cth), schedule 2, s 20.

⁵⁵ ASIC v The Cash Store Pty Ltd (in liquidation) [2014] FCA 926.

Issue 4: Unreasonable fees

16	If prescribed fee caps were introduced, who should they apply to, and what process and criteria should be used to set them?
17	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
18	Do you have any suggestions for the design of options for reducing unreasonable fees? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
19	Which options for changes to fees regulation would you support? Which would you not support? Please explain how you made your assessment.
20	Have you seen issues with excessive broker fees, or other unavoidable fees charged by third parties, being added to the loan? If so, are there any specific changes that should be made to the regulation of third-party fees? What would be the impact of these changes on lenders, borrowers and third parties?

General comments about the fee provisions

164. The Discussion Paper identifies two issues relating to the regulation of fees:
- 164.1 difficulties enforcing the prohibition against unreasonable fees; and
 - 164.2 a lack of clarity about when a fee is unreasonable.
- It also proposes three options for overcoming these issues.
165. We comment on our experience of each issue in general terms and then discuss each proposed option. In summary:
- 165.1 If the current requirement for fees to be reasonable is retained, we strongly support the introduction of an offence of failing to substantiate a lender's fees. This would greatly assist the Commission's assessment of the reasonableness of fees, improve the ability for the Commission to take deterrent enforcement action and potentially improve lender compliance; and

165.2 We note some issues for consideration relating to Fee Options B and C if the review progresses proposals to alter the regulation of fees in a more substantial way.

Commission's enforcement of the fee provisions

166. The fee provisions are unnecessarily complicated, difficult for borrowers and for the Commission to enforce, create compliance costs for lenders and potentially obscure the cost of credit.
167. It has been time consuming and expensive to clarify the correct approach to determining whether a fee is unreasonable under the existing fee provisions. The Supreme Court released its decision in *Sportzone*⁵⁶ on 21 May 2016 after seven years of litigation. In the course of that investigation the Commission spent over \$2m including \$536,000 on expert economic and accounting evidence.
168. While the Supreme Court's decision gave invaluable guidance about how the fee provisions should apply, the practical application of the *Sportzone* test differs from business to business. This affects the length of the Commission's investigations and consequently, our ability to obtain timely enforcement outcomes. The average length of our fee investigations is over a year. In the cases and investigations where we have used expert evidence we have incurred on average \$184,000 in expert costs.
169. We have obtained four convictions relating to fees since *Sportzone*. We filed proceedings against Harmony in relation to its platform fee in August 2017 and we currently have several ongoing fee investigations.

⁵⁶ *Sportzone Motorcycles Limited (in liquidation) et al v Commerce Commission* [2016] NZSC 53.

**Summary of the Commission’s enforcement action relating to fees since
*Sportzone***

- In 2016, Gavin Marsich and Twenty Fifty Club Limited were found guilty of breaching s 41 of the CCCFA by charging a “marketing koha” of 50% of the loan amount.
- In 2016, Ace Marketing Limited pleaded guilty to breaching s 41 by charging a PPSR registration fee in circumstances where it did not register a financing statement.
- In 2017, Acute Finance Limited pleaded guilty to four charges of breaching s 41 by charging a fee for its repayment waiver that exceeded its reasonable costs;
- Also in 2017, Cash to You pleaded guilty to breaching s 41 by charging a “security registration fee” in circumstances where it did not register a security.
- In 2017, we entered into a settlement agreement with Rapid Loans Limited under which the company agreed to repay approximately \$1.4m in unreasonable establishment, monthly administration and default fees.

Assessment of reasonableness is complex

170. In simple cases, the Commission may be able to take prompt action against lenders that have not undertaken the activity for which the fee is charged or where the fee is set in such a way that it clearly cannot relate to the lender’s cost (for example percentage based fees).
171. In all other cases, the Commission is required to undertake a fine-grained, forensic analysis of the particular lender’s costs and, in each case, make an assessment of whether those costs are specific to a particular loan transaction and therefore whether the fee is reasonable. This process presents a number of challenges.
172. First, in undertaking these assessments the Commission is highly reliant on lenders to provide sufficiently detailed and accurate information relevant to their costs and lending activity. Because the information goes to the heart of the operation of a lending business, the analysis can be time consuming if a lender does not have sound records immediately available.
173. Some lenders are uncooperative or slow to produce information, even when the production is compelled using the Commission’s information gathering powers. The

veracity of any analysis undertaken by the lender can also be difficult and/or time consuming to challenge. For example:

- 173.1 We need to rely on information provided by the lender when determining/ assessing an “appropriate” apportionment of costs. For example, lenders commonly assess the apportionment of business overheads (e.g. rent) based on the proportion of time spent on fee-related activity by personnel occupying the space. Similarly, for ‘bottom-up’ cost calculations,⁵⁷ we are, to some extent, required to rely on the lender’s estimate of time (minutes) spent on particular tasks.
- 173.2 We are reliant on information provided by lenders about calculated averages, including activity frequency and complexity. We must obtain detailed information about multiple possible variations within a fee-related process, in order to determine/ assess what is an **appropriate average** cost. For example, cost-driving activities are frequently described as happening “*sometimes*” or “*if required*”.
- 173.3 Isolating costs within **technology systems** is becoming increasingly complex, with multi-dimensional systems being utilised for a number of functions. It is challenging for us and for lenders to isolate the costs associated with fee related activity from the general cost of business.
- 173.4 Costs associated with **unsuccessful loan applications** are typically not transparent. We often encounter challenges identifying costs associated with activity spent on unsuccessful applications due to limited record keeping by lenders and/ or highly automated fixed-cost systems which are utilised for ‘end to end’ processes.
174. Second, an assessment of the reasonableness of one fee usually requires some assessment of the reasonableness of all fees charged by a lender. This is because costs allocated to individual fees may appear reasonable when assessed in isolation but the overall allocation across all fees may represent an unreasonable recovery or over-recovery of costs. This requires an assessment of all fees charged even if our investigation is focused on complaints or suspicions about one fee in particular.
175. Third in the event that a lender is uncooperative and/or withholds information during an investigation and/or has failed to undertake a proper assessment of the reasonableness of its fees when setting those fees, the Commission has the **burden of proving** that fees are *unreasonable*.⁵⁸ This is a high burden of proof in circumstances where an assessment of reasonableness relies upon information

⁵⁷ An assessment of costs associated with the matter giving rise to the fee by working out tasks and the cost of performing them. It can be compared with a “top down” approach where lenders take their known costs and apportion them to certain credit-related tasks.

⁵⁸ We have had several lenders refuse to provide us with their fee setting analysis on the basis that it was privileged.

uniquely in the possession of the lender. In addition, all compliant lenders ought to have undertaken the relevant analysis before charging a fee and ought to have the required information available for production to the Commission. Although it is implicit that a cost accounting exercise should be carried out *in advance* of setting fees, the current legislation does not expressly compel lenders to undertake this exercise or to retain records to support this process.⁵⁹ They can perform a reasonableness assessment retrospectively to meet any investigation by the Commission and in some cases lenders have claimed privilege over their analysis and refuse to provide it to us.

176. Finally, inevitably, the complexity of this analysis means that the fee provisions are practically only enforceable by the Commission because borrowers are unlikely to have (or to be able to obtain) enough information about the lender's business to be able to assess how a lender's fees relate to its costs. If self-enforcement by borrowers was deemed an appropriate policy objective, then a more simple assessment of the lawfulness of fees could be considered by the review.

Lack of transparency in cost of credit

177. Our Lender Website Review identified that borrowers may face challenges when comparing both interest rates and fees across lenders.
- 177.1 The Review identified 500 different named fees (796 fees over 135 lenders). The different types of fees makes it difficult for borrowers to know if they are comparing like-for-like fees;
- 177.2 Some fees were listed as one-off, others listed as 'per day'/per transaction/per km. Again, it is difficult for borrowers to compare the effect of these fees on the cost of credit; and
- 177.3 Some fees are presented as optional, avoidable or discretionary which complicate borrowers' understanding of the cost of their loan.
178. There is a significant difference in the amount of fees charged by lenders, which suggests that lenders may not be competing on fees. In addition, borrowers are likely to have difficulty ascertaining the effect of these fees on the total cost of the transaction. For example:
- 178.1 establishment fees ranged from \$5 - \$5000;
- 178.2 general fees (\$0) \$10 - \$1,846 (legal fee) – largest total of general fees charged \$4890.50;
- 178.3 lenders charged a range of periodic fees. It is difficult to compare effect of this across loan book.

⁵⁹ We have set out these principles in our comprehensive Credit Fee Guidelines, but these do not have the form of law.

We considered the impact an establishment fee would have on a potential “effective interest rate” for five lenders we were currently investigating. We used a loan of \$500 with a term of six weeks. The difference between the interest rate advertised and the effective interest rate ranged from 33.5% - 815.9% emphasising the impact fees can have on the cost of credit.

Lack of incentives for efficiency

179. The fee provisions potentially incentivise lenders to increase the size and number of fees – particularly in order to keep up with other lenders. In general, our investigations have revealed an increase in the number of fees and size of fees charged by lenders over time.
180. By enabling lenders to recover all reasonable costs in connection with matters giving rise to the fee, there is no incentive for lenders to reduce costs through process efficiencies. Lenders seek to differentiate themselves in the market through service offerings, and in doing so incur costs which can be ultimately passed on to borrowers.
181. We are not aware that lenders are competing to any real extent on fees. The Ministry of Consumer Affairs noted in its 2009 review of the CCCFA:

Lenders do not appear to compete to any extent on non-interest rate elements they are required to disclose, such as fees and charges. Consumers would also appear not to approach various lenders to obtain other disclosure information to compare. It is possible that the CCCFA’s requirement for fees and charges to be reasonable may give consumers the impression that looking at these elements is not worthwhile as they are already regulated for, in other words “the government has already checked this out, it must be safe”.⁶⁰

Fees Option A: Require lenders to substantiate reasonableness of fees.

182. In the event that the CCCFA retains existing requirements for fees to be reasonable, we would strongly support a requirement for lenders to substantiate the reasonableness of their fees at the time that the fee is set. A failure to provide information that substantiates the reasonableness of a fee should be an offence or subject to pecuniary penalties. An appropriate provision could be modelled on the similar requirement to substantiate a representation, contained in s 12A of the Fair Trading Act 1986.
183. We agree with the costs and benefits of this option identified in the Discussion Paper and we agree that this is the most simple of the proposed options to improve fees regulation.
184. We also consider that:

⁶⁰ Ministry of Consumer Affairs “Review of the Operation of the Credit Contracts and Consumer Finance Act 2003” (September 2009).

- 184.1 This would incentivise greater attempted and actual compliance by lenders by effectively creating an offence of failing to undertake a proper reasonableness assessment at the time a fee is set rather than allowing retrospective attempts to undertake this assessment to try to justify a fee after it has been charged.
- 184.2 This in turn should improve the quality of information available to the Commission when using its existing information gathering powers to investigate the reasonableness of fees. The Commission could more frequently focus its investigation on whether the lenders' assessment was reasonable rather than having to reconstruct the lenders' business and costs to undertake that assessment itself. This would have significant efficiency advantages for enforcement.
185. The Commission could take enforcement action for breach of the substantiation requirement in cases where lenders had not assessed the costs associated with the matter giving rise to the fee, or quite obviously failed to do so properly – regardless of whether the fee was or was not unreasonable. It would not need to expend significant resources to assess the lender's business and costs to prove that the fee was itself unreasonable. This would constitute a second offence which the Commission could pursue if it chose to.
186. In the event that the CCCFA retains existing requirements for fees to be reasonable, we note that the review could also consider the utility of providing more prescription about the type of costs that lenders can take into account in setting fees, to improve clarity and certainty in the assessment of reasonableness for lenders and for the Commission.

Fees Option B: impose specific fee caps in regulation

187. This option for fee regulation involves:
- 187.1 the prohibition of some mandatory fees;
 - 187.2 the introduction of caps for other named mandatory fees;
 - 187.3 regulation of prepayment fees as at present; and
 - 187.4 no regulation of fees for optional services as is currently the case.
188. Lenders would recover any profit and/or costs not recovered within the fee caps through their interest rates. The requirement for fees to be reasonable would be abandoned and in this respect Option B presents a more dramatic change to fee regulation than is proposed under Option A.
189. We agree that this option could simplify the enforcement of fee regulation and provide greater clarity for lenders, borrowers and the Commission. To that end, we broadly agree with the likely costs and benefits described in the Discussion Paper.

190. We note the following additional considerations which are relevant when designing any fee cap:
- 190.1 In general more prescriptive requirements provide certainty and are easier for lenders to comply with and easier for the Commission to investigate and enforce. This proposal could reduce compliance costs for lenders if the fee caps and criteria for their application are sufficiently clear. However, we note that the Discussion Paper contemplates potential for specifically targeted or broadly applied fee caps and we reiterate the need for clarity and certainty in designing caps which was outlined earlier in our submission.
 - 190.2 The design of the fee caps should properly contemplate the potential for avoidance, also discussed earlier in this submission.
 - 190.3 We suggest that the effectiveness of this option may be maximised if lenders are permitted to charge a relatively small number of specified fees; for example those fees where the lender incurs a significant cost and where there is a clear justification for those costs not being included in an interest rate. In our experience establishment, administration and direct debit and default fees are among the most commonly charged. Alternatively lenders could be permitted to charge a total maximum amount in fees.
 - 190.4 The Discussion Paper notes that if Cap Option B or C was pursued then high-cost lenders may already be covered by fee caps.⁶¹ If specific fee caps are adopted, we recommend that they apply across the industry. This will assist clarity and certainty for lenders, aid enforcement for the Commission and assist borrowers to easily compare credit products. This need not, however, prevent fees from being capped different levels for different loan types.
191. Finally, we agree that a significant challenge for this option would be setting and updating the fee caps.⁶² For example:
- 191.1 Fee caps will need to be set at an appropriate level that allows lenders to recover upfront costs while ensuring that borrowers are able to compare credit products.
 - 191.2 Regard would need to be had to the effect of any fee caps on any comparison interest rate that might be adopted for advertising and disclosure purposes (discussed below).
 - 191.3 Caps would need to take into account the potential differences between lenders and/or products.

⁶¹ Additional Information Paper at [350].

⁶² Additional Information Paper at [351].

191.4 The review will need to carefully consider whether the complexity and potential cost of the task may outweigh any potential benefits derived from more simple enforcement. For example, whether the process of setting and reviewing caps would be any less resource intensive, or encounter fewer difficulties with practical implementation than the assessment of reasonableness of fees under existing law.

191.5 Consideration would need to be given to the appropriate method of setting caps. The Discussion Paper proposes that this could potentially be done through regulation delegated to the Commission. We do not consider that delegation to the Commission would be appropriate given the nature of the task. However, once set, the monitoring and enforcement of any fee caps could comfortably remain within the scope of the CCCFA.

Fees Option C: disclosure and advertising based on an annual percentage rate that combines interest and fees

192. Under this option, regulation of mandatory fees is proposed to be removed and interest rates and fees would be bundled into an annual percentage rate for disclosure and advertising purposes. We refer earlier in this submission to a **comparison rate** which is a similar concept.
193. We agree that a comparison rate may improve borrowers' ability to compare competing credit products. We understand that the proposal contemplates that a comparison rate would be used in advertising and general methods of disclosure such as disclosure online. However, individual borrowers would still require disclosure of the particular interest rates and fees (and potentially the equivalent or effective interest rate applicable under any cap) that applies to their particular loan. To this extent, the option has some limitations if the borrower's particular loan varies from the product used to calculate the advertised comparison rate. It has some potential to confuse, rather than assist, some borrowers to compare lender offerings.
194. We also note the criticisms of this requirement when it was used in the past. Any decision to return to this option should involve careful consideration of the identified shortcomings.
195. In recommending dispensing with a finance rate in the 1999-2000 Credit Reforms the Ministry of Consumer Affairs cited limitations with annual finance rates, including issues relating to the timing of disclosure and a lack of clarity about what fees should be included and issues about its effectiveness when comparing loans of different amounts or time periods.⁶³ We agree that there can also be difficulties calculating a comparison rate for revolving credit products. Consideration should be given to

⁶³ Ministry of Consumer Affairs "Consumer Credit Law Review Part 3: Transparency in Consumer Credit: Interest, Fees and Disclosure" ISBN 0-478-23472-4(April 2000).

whether these limitations undermine the benefits intended by adoption of a comparison rate.

196. We consider that some inherent limitations in the use of a comparison rate could be mitigated by:

196.1 Requiring any comparison rate to include fees that are unavoidable for the borrower entering into the loan. For example the comparison rate should take into account unavoidable brokerage or establishment fees.

196.2 Requiring lenders to use a comparison rate in all advertising and to give the comparison rate the same prominence as any other interest rate used.

196.3 Requiring lenders to include a warning about the limitations of the comparison rate in any advertising such as a warning that the comparison rate might change depending on the length of the loan.⁶⁴

196.4 Requiring lenders to disclose the amount of the comparison rate for the borrower's particular loan in initial disclosure documents together with the total cost of credit for the loan.

197. We also recommend that if a comparison rate is adopted that the CCCFA retains a high-level regulation of fees. For example:

197.1 Enabling the Commission at the very least to continue to act in cases where lenders charged fees for services that were not performed or where the fee was excessive or unconscionable; and/or

197.2 Ensuring that default fees and credit fees that were not included in a comparison rate (such as prepayment fees) were reasonable; and/or

197.3 Requiring lenders to advertise a comparison rate as well as ensuring that their credit fees were reasonable under the existing law. This would give consumers two points of comparison, the comparison rate and the annual interest rate.

Potential for tightening regulation of third party fees

198. We support reform of the way in which the CCCFA treats third party fees. We agree that the current provisions of the CCCFA create uncertainty about which non-associated third party fees are credit fees and, if they are to be assessed for reasonableness, what the appropriate test is. We support clarification of these matters by statute.

199. Fees charged by non-associated third parties can be credit fees. The High Court in *Commerce Commission v Harmony* [2018] NZHC 1107 recently provided some

⁶⁴ National Consumer Credit Protection Regulations 2010 (Cth), s 71(11).

useful guidance about when a fee is “payable under a credit contract”. In that case *Harmony* claimed that this phrase required the credit contract to provide the substantive obligation to pay the fee and that it did not refer to the mechanics of payment. The Court rejected this approach saying:

...although the obligation to pay the Platform Fee arises under the Borrower Agreement, payment is not required until settlement and then it must be way of deduction from the amount of the loan. It is because the Platform Fee forms part of the loan amount, and therefore attracts interest, that it should be treated differently from the way it would be treated if, for example, it had been payable in cash. If it were payable in cash directly to *Harmony* it would not be payable under the credit contract, it would genuinely be a brokerage fee paid to *Harmony* for arranging the loan. But the borrower must incur the cost of credit under the Loan Contract and pay the fee from the loan monies. This is not merely technical. In ordinary language the fee is payable under the Loan Contract.⁶⁵

200. The High Court’s opinion may be interpreted as persuasive but not binding. We support any amendments to the CCCFA to make the policy position clear:

200.1 We suggest that where the borrower is not able to obtain the loan without paying the fee, it should be included in the cost of credit and should be required to be reasonable. In some instances this may include broking fees. This will ensure consistency across the industry and improve transparency for borrowers.

200.2 Establishment fees, insurance premiums⁶⁶ and default fees should be subject to the reasonableness provisions even if they are charged by non-associated third parties.⁶⁷

200.3 There should be clarification about how the “reasonableness” of fees charged by non-associated third parties should be assessed. Neither *Sportzone* nor the *Harmony* decision deals with how section 41 applies to credit fees charged by non-associated third parties. The Commission has attempted to provide some guidance about what might be relevant in considering whether third party enforcement costs are reasonable in our 2017 Credit Fee Guidelines.⁶⁸ We suggest that similar considerations might apply to non-associated third party credit fees but we would strongly support clarification by statute.

Broking fees

201. We frequently see high broking fees charged on consumer credit contracts. Brokers fees appear to be frontloaded into the contract and paid by the lender directly to the broker. It is not always clear whether the borrower understood they were dealing with a broker, whether the broker is actually providing a service to the borrower (or

⁶⁵ *Commerce Commission v Harmony* [2018] NZHC 1107.

⁶⁶ CCCFA, s 5(a) includes these fees in the definition of a ‘credit fee

⁶⁷ The legislation should clarify whether establishment fees charged by non-associated third parties are credit fees pursuant to s 5(a)(i) of the definition of credit fees or excluded from the definition by s 5 b(v).

⁶⁸ Commerce Commission “Consumer Credit Fee Guidelines (30 June 2017) at [158].

rather to the lender), whether the fee is genuinely avoidable by the borrower or what the relationship is between the broker and the lender. Examples of high broking fees include:

- 201.1 a \$495 fee charged on a \$9,000 loan for a motor vehicle (together with an establishment fee of \$375 and additional fees and charges of \$2493.34);
- 201.2 a \$600 “introducer fee” charged on a \$8,995 loan for a motor vehicle (together with a \$480 establishment fee and a \$920 fee for a repayment waiver).
- 201.3 a \$1,045 fee on a \$25,000 loan (together with a loan establishment fee of \$750 and other fees of \$343,64).

Options to provide greater consumer protections for debt collection

21	Is this an accurate picture of the problems for consumers experiencing debt collection? Do you have information that confirms or refutes these issues, or sheds light on how widespread or severe they are?
22	What information should be provided to borrowers by debt collectors? When and how should this information be provided?
23	Do you agree with our assessment of the costs and benefits of the options for addressing irresponsible debt collection? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
24	Do you have any suggestions for the design of options for addressing irresponsible debt collection? In particular, what is an appropriate frequency of contact with debtors before (and then after) a payment arrangement is entered into? Please state the likely impact of your proposed options on borrowers, lenders and the credit market.
25	Which options for changes to the regulation of debt collection would you support? Which would you not support? Please explain how you made your assessment.

General comments on debt collection

203. We support law reform and regulation of the debt collecting industry. The Commission continues to receive a large number of complaints about debt collection with 97 complaints being received from 1 June 2016 to 30 May 2017.
204. The focus of law reform appears to be on debt collecting activities for consumer credit contracts (and presumably contracts that fall under Part 3A of the Act (**Part 3A Contracts**)). But, in our experience, many debt collection issues arise in relation to other types of contracts (for example utilities or other contracts for services). In the ordinary course of events these would not be credit contracts or consumer credit contracts. As with mobile traders, CCCFA reform will not be sufficient vehicle to address all issues arising in debt collection. In this section of the discussion paper we use the term “creditor” to describe the owner of a debt and “debtor” to describe the person who owes the debt whether or not it arises from a credit contract.
205. In our experience, there are two main methods of collecting consumer debt in New Zealand - on a contingency basis or via assignment of the debt.
- 205.1 Contingent debt collection is carried out by a collection agency on behalf of, or as an agent of, a creditor. The creditor retains ownership of the debt and

the collection fee for the service is very likely to be an agreed percentage of the total debt outstanding. This fee is usually added to the debt at the commencement of debt collection and the collecting entity will retain a percentage of each payment made by a borrower before remitting the balance to the creditor.

205.2 Debt collection via assignment involves the sale of debt to a collection agency, usually for a price lower than the ledger value of the debt. The collection agency becomes the creditor and, in the absence of a variation agreed with the borrower, is subject to all the terms and conditions, including fees, of the original credit contract. Assigned debt is sometimes also referred to as “purchased debt”.

206. Although we are providing submissions on Options A to E we most strongly support reform relating to making third-party debt collection agencies directly subject to the CCCFA (Option D) and making external debt collection fees cost-based (Option E).

Debt Collection Option A: require key loan information to be shared with the debtor at commencement of debt collection.

207. We support this proposal to the extent that disclosure would provide useful information to debtors. There is some evidence that debtors are not provided with information about the debt including where and when the debt arose, particularly for non-consumer credit debt. This may contribute to debt collectors making the type of false and misleading claims identified in the Discussion Paper. It may also impact on the debtors’ ability to dispute the debt.

208. To limit ambiguity, if this option is adopted we consider there need to be clear provisions outlining:

208.1 when the requirement to provide disclosure is triggered. Creditors and debt collection agents may take a range of steps to address default, from writing a letter to issuing summary judgment proceedings. Any regulation will need to consider the point at which debt collection disclosure would need to be provided and will require a clear definition of what is meant by “debt collection action”. A form of disclosure is already required where repossession action is contemplated in the form of a repossession warning notice. Duplication of regulation in this area should be avoided.

208.2 how the lender or debt collector can provide the key information to the borrower. Because the information required is similar to initial and continuing disclosure relating to consumer credit contracts, we suggest that the s 35 requirements, on how disclosure is made, should apply.

208.3 what information needs to be provided. In addition to the information identified in the Discussion Paper, if Option D was adopted and third party debt collectors were required to be registered on the FSPR and belong to a

dispute resolution scheme, disclosure requirements similar to those imposed on creditors when a debt is transferred to another creditor⁶⁹ could also be imposed on debt collectors.

209. Consideration should be given to whether creditors should be required to use a standard form of disclosure.
210. Given the similarity between this option and current initial, variation and continuing disclosure requirements relating to consumer credit contracts in the CCCFA, we suggest that a breach of these requirements, in respect of Part 3A contracts, could similarly be an infringement offence.

Debt Collection Option B: require debt collectors to offer an affordable repayment plan

211. We are not in a position to comment on whether this proposal might assist borrowers who are the subject of debt collection action or whether the compliance and regulatory costs involved might exceed the benefits available to borrowers.
212. However, from an enforcement perspective, if this proposal was adopted, we recommend consideration is given to:
- 212.1 a clear and unambiguous explanation of the process expected to be followed by debt collectors;
- 212.2 any incentives that this option may create for creditors to take enforcement action such as repossession or court proceedings in preference to debt collection, and the potential costs and benefits to the parties of those incentives. For example, if a creditor (or debt collector acting as the creditor's agent) could not demand repayments in amounts greater than provided in the original terms of the contract or the maximum amount affordable regardless of whether this meant the loan would be repaid in a reasonable time, creditors may look to other methods to efficiently recover the debt; and
- 212.3 Applicable sanctions for breach.
213. Given the anticipated costs associated with this reform it would be important to ensure that enforcement and advocacy were appropriately funded.

Debt Collection Option C: specify appropriate limits regarding contact between the debt collector, borrower and other persons

214. As noted in relation to Option B, we are not in a position to comment on whether this proposal might assist borrowers the subject of debt collection action or whether the compliance and regulatory costs involved might exceed the benefits available to borrowers.

⁶⁹ CCCFA, s 26A.

215. We are aware of creditors who have a policy of multiple contacts to debtors once they are in default.
216. If this option is progressed we recommend consideration of:
- 216.1 whether restrictions on contact may reduce the ability of creditors and debtors to come to arrangements to repay and could lead to more court action (which is not necessarily less stressful).
- 216.2 whether contact limits would apply
- 216.2.1 for a set period of time; or
- 216.2.2 for the life of the debt; or
- 216.2.3 to particular times of the day.⁷⁰
- 216.3 the implication any limits would have on the application of the harassment and coercion provision under s 23 of the Fair Trading Act 1986.
- 216.4 whether this option has the potential to incentivise debt collectors to pursue repossession or court action rather than contacting debtors to reach an affordable repayment plan.

Debt Collection Option D: make third party debt collection agencies subject directly to the CCCFA

217. We support amendments to make third party debt collection agencies directly subject to the CCCFA. It would ensure that the same compliance requirements applied to all debt collectors regardless if the action is undertaken by a creditor, a collector who is assigned a debt, or is a third party collecting debt on a contingency basis.
218. We note that this option does not address issues relating to collection of debts that are not subject to the CCCFA – for example, debts for unpaid services, which are frequently subject to debt collection.

Debt Collection Option E: make external debt collection fees cost-based

219. We support this option. We have heard argument that the CCCFA is ambiguous about how it applies to fees charged by third party debt collectors. In our view these fees are default fees and are required to be reasonable. However, we support law reform that clarifies the position.
220. We have evidence of debtors being charged percentage-based fees when the debt is collected on a contingency basis.

⁷⁰ Similar to s 83S of the CCCFA.

221. The Commission has received complaints relating to the level of fees charged by third party debt collectors.
- 221.1 During a recent investigation, a third party debt collector added collection costs of 30% of the debt to a debtor's account. The original debt owing totalled \$29,335.79 and the collection costs were \$8,762.64. The total debt was therefore \$38,088.43.
- 221.2 In another complaint received by the Commission, the original debt referred to a third party debt collector was \$46,161.69 and when the collection fees of \$11,796.87 were added, the total debt was \$57,958.56.
222. We have reviewed and gathered information about the fees charged by other third party debt collectors, including large debt collectors. Examples of fees being charged include:
- 222.1 a contingent debit fee of 25% charged for each repayment instalment paid by a debtor.
- 222.2 several collectors charge a commission of 20%.
- 222.3 25% to 45% commission on recovered monies depending on the size of the debt. The same collector also adds a 15% margin to third party disbursements and fees.
- 222.4 information gathered from several debt collectors' websites detail that a commission charged for collection can range from 15% to 45% depending on the size, age and history of the debt.
223. This proposal would effectively prohibit percentage-based fees. However, the following matters should be considered further if this option is progressed:
- 223.1 we agree that creditors may seek to recover the additional debt collection costs through increasing interest rates. In practice, this would increase the costs for all debtors, regardless of whether debt collection action was taken. This may mean that those people that repay their loans without issue would subsidise those that did not. The question of who should bear the cost of debt collection may require further consideration.
- 223.2 reform relating to external debt collection fees should be considered in the context of the proposed potential caps and fee reforms identified in the Discussion Paper.

Other issues

Small business loans, investment loans and family trusts

26 Are you seeing harm from loans to small businesses, retail investors or family trusts as a result of them not being regulated under the CCCFA?

27 Do you think small businesses, retail investors or family trusts should have the same or similar protections to consumers under the CCCFA? Please explain why/why not.

28 Are there any other issues with the CCCFA or its impact on vulnerable people that are not addressed in this discussion paper? If so, what options should MBIE consider to address these issues?

224. We have not seen harm from loans to small businesses, retail investors or family trusts. We have had one complaint from a family trust on lending issues in the last 12 months. This is not necessarily to say that harm is not occurring. We would not expect to see complaints in relation to conduct that is not currently unlawful.
225. There may be some justification for providing CCCFA protection for family trusts. In our experience are run by “mum and dad” trustees who are likely to benefit from the CCCFA protections.

SUMMARY OF SUBMISSIONS

Reform Option	Summary of Commission Submission
Cap Option A: Limit the accumulation of interest and fees	Requires careful consideration of design to ensure that lenders are able to comply with the provisions and that Commission can enforce them.
Cap Option B: Reduce the highest interest rates and limit the accumulation of interest and fees	Potentially more straightforward to enforce but need to consider scope and anti-avoidance provisions.
Cap Option C: Set a low interest rate cap to eliminate high-cost lending	Potentially more straightforward to enforce but need to consider scope and anti-avoidance provisions.
Registration Option A: Expanded powers to deregister lenders and ban directors from future involvement in the credit industry	No clear benefit in deregistration powers. We support amendments to banning order provisions.
Registration Option B: Introduce a fit and proper person test in registration of lenders	There may be some benefits in introducing a fit and proper person test. Organisation tasked with undertaking this assessment will need to be properly funded.
Registration Option C: A comprehensive creditor licencing system	There will significant costs to a comprehensive creditor licencing system. We are not in a position to carry out a cost/benefit analysis.

Enforcement Option A: civil pecuniary penalties, statutory damages and expanded injunction orders for breach of lender responsibilities	We strongly support this option.
Enforcement Option B: directors' duties	There may be some benefits in this option. The extent of director liability for CCCFA breaches is a matter of policy.
Enforcement Option C: substantiation obligations for lenders	We strongly support this option.
Enforcement Option D: increase industry levy on creditor to help fund advocacy, monitoring and enforcement of CCCFA	We are agnostic about where our funding comes from but note that reform may increase cost of enforcement.
Enforcement Option E: require creditors and their agents to work with consumers' advocates if asked to do so, and in good faith	We support this option.
Responsibility Option A: introduce more prescriptive requirements for conducting affordability assessments	We strongly support this option.
Responsibility Option B: introduce more prescriptive requirements for advertising	We support this option.
Responsibility Option C: require disclosure to be in same language as advertising	We support this option.
Scope Option A: include credit contracts that charge default fees in definition of consumer credit contract	We do not support this option.

Scope Option B: prohibit price of goods or services sold on credit from exceeding the cash price	We support a comprehensive review of the mobile trader sector and consideration of wide ranging reforms to deal with mobile trader conduct.
Fees Option A: require lenders to substantiate reasonableness of fees	We strongly support this option if the fee provisions are to remain unchanged.
Fees Option B: impose specific fee caps in regulation	This option may create enforcement efficiencies but which fees are to be capped and at what level would need to be considered.
Fees Option C: disclosure and advertising based on APR	We are concerned about the effectiveness of this option.
Debt Collection Option A: increase disclosure requirements at commencement of debt collection	We support this option.
Debt Collection Option B: require debt collectors to offer and affordable repayment plan	If this option is adopted there should be clear and unambiguous obligations on debt collectors.
Debt Collection Option C: limit contact between the debt collector, borrower and other persons	We support this option.
Debt Collection Option D: make third party debt collection agencies subject to the CCCFA	We support this option.
Debt Collection Option E: make external debt collection fees cost-based	We support this option.