COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Effective from 1 December 2021

Due Diligence

This focuses on the new personal obligations of the directors and senior managers of lenders and mobile traders.

The law change creates a duty to exercise the care, diligence and skill that a reasonable director or senior manager (as the case may be) would exercise, to ensure that the business complies with its duties and obligations under Credit Contracts and Consumer Finance Act 2003 (CCCF Act).

This is an entirely new legal obligation and a considerable change to the law.

It starts on 1 December 2021.

Its purpose is to improve compliance with the CCCF Act by incentivising directors and senior managers to ensure that adequate compliance systems are in place.

The new duty of due diligence under the CCCF Act will apply to every director and every senior manager of a "lender."

What's a "lender"?

A "lender" means any person or business that provides credit under a consumer credit contract including some mobile traders.

The definition of "lender" also includes some mobile traders, whether or not their contracts are strictly "consumer credit contracts".

With the new law, directors and senior managers will have a personal obligation, and will face personal liability, for making sure the lender complies with its obligations under the CCCF Act and Regulations—a considerable change.

Directors and senior managers will need to exercise due diligence to ensure the lender complies with these obligations.

The idea is to encourage directors and senior management to drive a culture of compliance.

Directors and senior managers will need to make sure that the lender has good systems and processes in place for sticking to the rules.

Who are directors and senior managers?

A director is someone who has responsibility for managing, directing or supervising the management of a lender's business and affairs. That's regardless of their job title or designation.

It's not just people named on the companies register held by the Companies Office, but anyone who behaves like a director—i.e. those who exercise the powers and functions of a director.

The role of director isn't limited to lenders which are registered as companies. Lenders could be partnerships, trusts or other types of businesses.

Anyone with a governance role which could be compared to that of a director of a registered company—e.g. a partner in a partnership—is classified as a director when we are talking about due diligence.

A senior manager is someone whose position allows them significant influence over the management or administration of a business. This will differ for different businesses, depending on their size and structure.

The critical test here is the amount of influence the person, due to their role, has over the business—the actual role they perform in influencing the lender's activities rather than what is written on their job title.

When lenders register on the Financial Service Providers Register (FSPR) they will be required to name their directors and senior managers.

These people are all subject to the duty of due diligence while they remain in their role.

If, however, there are changes to personnel or to the organisation, then other people may assume this duty—regardless of whether they are identified as directors and senior managers on the FSPR.

A failure to identify a director or senior manager on the FSPR does not mean that that person is not required to comply with the due diligence duty, so think carefully about who the directors and senior managers are.

What does due diligence mean?

As a director or a senior manager, you must take reasonable steps to make sure the lender does these things:

→ establishes and maintains procedures, which may or may not be automated, that are designed to achieve compliance with the CCCF Act and Regulations;
→ requires its employees and agents to follow those procedures;
→ undertakes reasonable checks on whether the procedures do what they're meant to and are being used correctly;
→ has methods in place to systematically identify problems with the effectiveness of its procedures; and
→ promptly fixes any problems it discovers.

There may be other reasonable steps required. For example, we suggest ensuring that the lender is checking to ensure sales incentives do not encourage non–compliance with the law.

We also suggest that the lender has procedures in place to ensure its contracts are not oppressive or unfair.

The care, diligence and skill required from you—as a reasonable director or senior manager—will vary between individuals, depending on a number of things.

It depends on:

→ the size of the business and nature of the credit the lender provides;
→ the nature of your responsibilities as a director or senior manager;
→ how influential you are in the parts of the business governed by the law. The greater the influence you have, the greater the care, diligence and skill that will be expected of you.

Whether you have met your duty will be assessed objectively—i.e. whether you have exercised the care, diligence and skill that a reasonable director or senior manager of a lender of the type and size of your business and with your responsibilities should have exercised.

You cannot avoid your responsibility for due diligence by expecting someone else will do it. It's not enough for you to assume or trust that another person in the business is taking care of compliance.

You will not necessarily breach your due diligence duty just because the lender breaches the CCCF Act. The important thing is that you have taken reasonable steps to ensure compliance.

You should keep records of what you have done to meet your duty.

Liability for a breach of the due diligence duty doesn't disappear or refresh after a director or senior manager leaves the business.

That director or senior manager can still face consequences for failing to meet their duty while they were a director or senior manager.

Similarly, failures in a lender's compliance that arose before a director or senior manager assumed their role can still expose that individual to liability where that individual does not ensure the lender takes reasonable steps to identify the issues and remedy them.

So what are the penalties?

There are significant personal consequences for breaching your duty of due diligence.

You are personally liable if you fail to exercise the necessary level of care, diligence and skill.

If you breach your due diligence duty the court can order you to pay a penalty of up to $200,000.

Body corporates are unable to indemnify you against this penalty (or for costs incurred in defending legal proceedings).

You are also unable to obtain insurance to cover penalties (and defence costs in any legal proceedings).

If the court finds that the lender has breached the CCCF Act, that you have breached your duty of due diligence and that borrowers are entitled to recover statutory damages or exemplary damages, you may be liable for them too.

We strongly recommend that you obtain legal advice:

- To make sure you know what the lender has to do to comply with the CCCF Act;
- Also what you need to do to meet your due diligence duty.

You will need to understand and keep up to date with lender's obligations under the CCCF Act and Regulations.

You can rely on information from subject matter experts (e.g. legal advisors) if it's reasonable to do so.

However, in order to meet the duty of due diligence you should have enough knowledge about the nature of the credit being provided, the lending tasks and the lender's obligations under the CCCF Act.

You should also know enough to ask the right questions of, and challenge information provided by, any subject matter expert.

Where do you go for more info?

The Commerce Commission has issued guidance on these new due diligence duties and it is available on the Commission's website.

It includes more information on establishing systems and procedures, ensuring that they work, ensuring that staff follow them, checking for issues with those systems and remedying issues that arise.

Links to existing and relevant resources:

Commission Guidance—Due diligence duties for directors and senior managers

These are the relevant sections of the Act:

Subpart 9 (section 59B) inserted into CCCF Act on 1 December 2021 by section 23 of the Credit Contracts Legislation Amendment Act 2019.

(All section and regulation references are as at 1 December 2021).

ACTION

Individuals need to understand whether they are a director or senior manager of a lender, and if they are what the due diligence duty is and how they can meet it.

IMPACT

It means the senior figures at any lending business now have a personal duty to ensure that the lender complies with its duties and obligation under the CCCF Act.

This material provides guidance only. It is not intended to be definitive and should not be used in place of legal advice. You are responsible for staying up to date with legislative changes.

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