COMMERCE COMMISSION NEW ZEALAND

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Submission to the Commerce Select Committee on the Credit Contracts and Financial Services Law Reform Bill

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Introduction - the need for change

1. The Commerce Commission (Commission) has been responsible for enforcing the Credit Contracts and Consumer Finance Act 2003 (the Act) for 10 years. In that time it has become very clear that effective consumer credit laws are essential for the protection of New Zealanders from improper credit practices.

2. We think the Act is not as effective in protecting the interests of consumers as it could be. This review provides the opportunity to improve the protection currently afforded to consumers.

3. Our submissions are intended to assist the Commerce Select Committee to ensure that the Credit Contracts and Financial Services Law Reform Bill (the Bill):

    3.1 achieves its stated purposes;

    3.2 clearly sets out the rights and obligations of creditors and debtors; and

    3.3 is readily enforceable by debtors and by the Commission.

4. The Commission supports the objectives of this law reform and supports the Bill's primary purpose of protecting the interests of consumers. The Commission also supports the Bill's secondary purposes, which include promoting the confident and informed participation by consumers in credit markets and facilitating fair, efficient and transparent credit markets.

Why change is necessary

5. Change to New Zealand's credit law is necessary. Enforcing the current law has been a challenging task for the Commission. We have taken action in both clear-cut and grey-area cases. But mostly, due to the lack of clarity of many of the key provisions, our enforcement actions have focussed on clarifying the law (with mixed success) so that credit market participants know where they stand.

6. For example, the Commission spent over $1 million in litigation proceedings under the Act for the 2012-2013 financial year. The bulk of the Commission's litigation costs for that year were not spent 'policing' straightforward breaches of the law, as we would prefer, but were absorbed by several major 'precedent cases' in which the fundamental interpretation of the Act was heavily contested. The Commission is budgeted to spend $2.1 million on major litigation under the Act over the 2013-2014 financial year.

7. Our ambition is for the legislation that governs such an important industry to be flexible and adaptive to different situations, but sufficiently clear in its terms as to provide well-understood rules that can be easily applied. We have limited our submissions to the amendments as proposed in the Bill. In addition we have recommended some easy-fix solutions for existing problems within the Act.

8. It is also important that credit laws, while balancing the interests of consumers and lenders, also provide clarity for business. We recognise that creditors provide a valuable service to New Zealander consumers and businesses. Creditors are, of course, entitled to recover their reasonable costs and obtain a return on the services they provide, enabling them to develop new products and services.

Suggested change

9. Our submission includes recommendations that we consider will:

   9.1 improve the enforceability of the Act by:

      9.1.1 amending the credit/default fees provisions to ensure they are clear, unambiguous and meet the policy objectives of the Act;

      9.1.2 ensuring that the introduction of the Lender Responsibility Code coincides with the introduction of the Lender Responsibility Principles (LRPs); and

      9.1.3 removing the offence of forcibly or wilfully obstructing a creditor lawfully repossessing goods.

   9.2 encourage compliance with the Act by:

      9.2.1 strengthening the provisions relating to offences and remedies;

      9.2.2 introducing infringement notices, which we consider will provide a very effective enforcement tool for dealing with less serious offences;

      9.2.3 clarifying the scope of the Act so that it is plain which kinds of credit contracts are captured and which are not;

      9.2.4 introducing new provisions relating to the actions of agents; and

      9.2.5 introducing a cooling off period for credit-related insurance, repayment waivers and extended warranties.[1]

   9.3 improve the quality of information to be provided to consumers by:

      9.3.1 clarifying the provisions relating to continuing disclosure;

      9.3.2 improving and simplifying the model disclosure forms;

      9.3.3 making sure that key information is provided in one document;

      9.3.4 reducing the timeframe for making disclosure following the creditor's exercise of a power; and

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[1] We note that proposed section 36U (clause 18) of the Consumer Law Reform Bill will give consumers a right to cancel an extended warranty providing it has not been entered into as a condition of a consumer credit contract.

9.3.5 introducing new provisions relating to advertising of interest rates.

9.4 make the language of the Act consistent and clear by:

9.4.1 ensuring certain terms used in the Act are well-defined and consistent;

9.4.2 clarifying whether the definition of interest includes default interest; and

9.4.3 clarifying the extent of a creditor's obligation to make continuing disclosure on a revolving credit contract where the creditor has ceased providing credit.

10. In addition, we propose that Parliament should amend the Financial Service Providers (Registration and Dispute Resolution) Act 2008 in order to improve the Commission's ability to enforce the Act.

11. We have provided the following summary of recommendations to guide the reader through this document.[2] We have structured our submissions to focus on, in order:

11.1 the fees provisions;

11.2 remedies and offences;

11.3 the scope of the Act;

11.4 suggestions as to how better quality information can be provided to debtors;

11.5 the need for clear and consistent language; and

11.6 the Responsible Lending Principles.

12. We have also included, as **Attachment A**, a list of drafting and technical issues we have identified.

13. **Attachment B** sets out a discussion of background materials to the credit law reform that led to the 2003 Act, along with judicial comment on the policy intention underpinning the fee provisions.

[2] References to "clauses" are to the clauses of the Bill and to "sections" are to proposed or existing sections of the Act.

Summary of Recommendations

	Section	Paragraph
The Fee Provisions		
We support the proposal to require costs to be "directly" related to the matter giving rise to the fee	Proposed ss44 and 44A	27
The Act should be clear about whether creditors can recover opportunity cost through fees	Part 2 subpart 6 (including) proposed amendments)	31
We support the proposed split of section 44	Proposed amendments to s44 and proposed section 44A	39
Parliament should either remove or confirm the effect of the "reasonable standards of commercial practice" test	Existing s44(1)(b)	41
We suggest Parliament considers further amending the prepayment provisions	Proposed s44(2)(b) and existing s51(1)(c)	46
Remedies and Offences		
Non-compliance with repossession provisions should be an offence	Proposed Part 3A	57
Non-compliance with the Lender Responsibility Principles should be an offence	Proposed Part 1A	65
The current level of penalties are not sufficient to promote compliance	Existing s103	69
Statutory damages are too low	Existing s89	73
Infringement notices should be introduced for breaches of the disclosure provisions and for breaches of Part 3A	Part 2 subpart 2 (including proposed amendments) and proposed Part 3A.	79
All obligations should have a corresponding sanction	Proposed ss7A, 9H and 9G.	87
The offence of obstructing a creditor lawfully repossessing goods should be removed	Proposed s103(1A)	92
The Bill should make it clear that creditors should be liable for actions of agents	Commission Recommended	93

	amendment	
Scope		
The Bill should clarify what is a "credit contract"	Existing ss6 and 7	94
The debtor's purpose in obtaining credit should determine whether a contract is a consumer credit contract	Proposed amendments to s11	99
The repossession provisions should apply to consumer credit contracts	Proposed Part 3A, amendment to s5 "consumer goods" and amendment to s11.	103
Parliament should clarify when the repossession provisions apply	Proposed ss83B and 83C	107
The Act should prohibit the charging of undisclosed credit fees	Commission Recommended amendment	111
The Act should be clearer about how it applies to Pawnbrokers	Proposed amendment to s10	112
There should be a separate right of cancellation for credit related insurance, repayment waivers and extended warranties	Commission Recommended amendment	116
Better quality of information		
Disclosure statements should be revised	Existing schedules 1, 2 and 3 and existing schedule 2 of the Credit Contracts and Consumer Finance Regulations (2004)	122
There should be requirements about the advertising of interest rates	Commission Recommended amendment	132
There should be changes to the timing of disclosure of a contractual change	Existing s23(3)	133
Clear and consistent language		
We think that some language used in the bill is unclear and will give rise to enforcement difficulties	Proposed amendments to s5 "cost of borrowing", proposed sections 9A, 9I, 83V, 83ZC,	134

	99A, 99B and 124, proposed amendments to s88, 99 proposed schedules 1AA, 3A, 3B.	
The Bill should be more specific about what is meant by a "reasonable commission" on credit related insurance	Proposed amendment to s45(5)	144
The Bill should clarify whether "interest" includes "default interest"	Existing section 5 "interest charge"	148
The Bill should clarify the creditors obligation to provide continuing disclosure in particular situations	Commission Recommended amendment	149
The Bill should clarify what happens if a creditor repossesses goods but does not offer them for sale	Proposed section 83S and 83ZG	154
Lender Responsibility Code and Principles		
The Lender Responsibility Principles and the Code should come into force at the same time	Commission Recommended amendment	158
The Lender Responsibility Principles should apply to all creditors within the industry	Proposed section 9B	161
Financial Service Providers (Registration and Dispute Resolution) Act 2008		
The definition of "creditor" in the FSP Act should be the same as the definition of "creditor" in the CCCF Act.	Existing section 4 "creditor"	168
The Registrar should be able to share information with the Commerce Commission.	Existing s34(4)	171
Dispute Resolution Schemes should be required to report to the Commission if they receive a series of material complaints against a credit provider.	Existing s64	175

The fees provisions

14. Sections 41 to 45 of the Act (the fees provisions) are central to its operation. Implicitly, the Act allows a creditor to recover its costs and profit in two ways: through fees and interest. There are few restrictions about how interest can be charged. A creditor is entitled to set its own interest rate constrained only by competitive forces. The fees provisions, however, restrict how a creditor can recover its costs through fees. This assists consumers in their comparison of the cost of credit.

Overview of issues

15. Because of the importance of the fees provisions, the Commission has focussed a large part of its enforcement effort in this direction. This has not been an easy undertaking, as the current provisions are capable of a variety of reasonable but conflicting interpretations. Unsurprisingly, in our experience, some creditors have tended to interpret these provisions in ways that better enable them to enhance their profits. Particularly, some creditors argue that the fees provisions permit greater flexibility in the charging of fees than we understand was intended by Parliament when these provisions were enacted.

16. We have issued compliance advice to creditors, taken criminal prosecutions and civil proceedings in the High Court, issued draft Credit Fees Guidelines to attempt to clarify the law, and undertaken creditor and debtor advocacy and other education. These actions have had mixed success. Some creditors comply with our guidance, others do not, and some still pursue practices that we consider to be non-compliant with the law.

17. The recent High Court decision in *Commerce Commission* v *Sportzone & MTF*[3] has gone some way to providing guidance on these provisions. But we see this review as an opportunity to clarify directly in the legislation as to Parliament's intention for these provisions and, if appropriate, to amend the fees provisions in a way that achieves the Act's purposes and provides clarity and certainty for market participants.

The Commission supports the proposed amendments

18. We generally support the proposed amendments to the fee provisions. The proposals go a long way to achieving clarity and consistency. We do though recommend a number of additional amendments.

19. In making these submissions we recognise that neither the Act nor the proposed changes in the Bill constrains a responsible creditor from recovering its reasonable costs and making a profit. Creditors are, of course, entitled to obtain a return on the services they provide, and this in turn enables them to develop new products and services. In that regard, this submission does not gainsay the creditor's ability to earn

[3] *Commerce Commission* v *Sportzone Motorcycles Limited (in liquidation), Motor Trade Finances Limited and MTF Securities Limited* [2013] NZHC 2531

a return, but rather seeks to achieve a clear, intelligible and readily-enforceable modern credit law.

Summary of recommendations in relation to the fees provisions

20. We think:

    20.1 that the Bill should entrench the *Sportzone & MTF*[4] decision in the law, by making explicit that a close and relevant connection is required between costs and the matter giving rise to the fee; and

    20.2 there should be recognition that different factors ought to be taken into account when assessing the reasonableness of each of credit fees and of default fees.

    20.3 Parliament should consider either:

        20.3.1 removing “reasonable standards of commercial practice” as a criterion for assessing the reasonableness of “other” credit fees and default fees; or

        20.3.2 confirming that “reasonable standards of commercial practice” places a limit on what might be a reasonable fee.

21. Additionally we think Parliament should make the following further amendments to the Bill.

    21.1 Creditors should only be able to obtain a reasonable estimate of loss on the full prepayment of a fixed interest rate loan. However, creditors should be able to recover reasonable administrative expenses on the full prepayment of a variable interest rate loan.

    21.2 Parliament should take this opportunity to clarify what is an “appropriate procedure” for calculating a reasonable estimate of a creditor’s loss on full prepayment of a fixed interest rate consumer credit contract.

22. We expand on these issues and recommendations and our reasoning in more detail below, after first outlining our understanding of the policy underpinning the fees provisions.

The policy underpinning the fees provisions

23. Our submission on the fees provisions is based on our understanding that the fees provisions of the Act are intended to protect consumers by addressing information asymmetries in the credit product market. We set out the basis of this understanding below.

<u>Materials that evidence policy underpinning fees provisions</u>

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[4] Ibid.

24. Background documents to the Credit Law Reform (from which the Act resulted) show that the Act was intended to address information asymmetries by enabling consumers to better compare the cost of credit. This was to be achieved through restricting the amount of the cost of credit that can be recovered through fees, by requiring that credit fees only recover costs that are attributable to the transaction.

25. The Courts have generally accepted that the Act was intended to protect consumers and provide debtors with sufficient information to make informed credit choices.

26. **Attachment B** sets out a discussion of these background materials and judicial comment on the policy intention underpinning the fee provisions.

We support the proposal to require costs to be "directly" related to the matter giving rise to the fee

27. The fees provisions currently provide limited guidance as to the degree of connection required between the costs a creditor seeks to recover through a fee and the activity to which the fee relates. This has resulted in uncertainty in the industry and problems for the Commission in enforcing the fees provisions. Some creditors have taken the approach that all costs they incur are recoverable through fees. Although this position is inconsistent with the policy of the fees provisions as set out in **Attachment B**, it is a position that is clearly arguable on the words of the section and one that has led to some creditors seeking to recover all costs through fees.

28. The Bill proposes to allow fees that recover only those costs "directly" associated with the matter giving rise to the fee. In the case of default fees the Bill proposes to allow fees that recover costs and losses that are "directly" associated with the type of default involved.

29. We support this proposed change. It provides clarity and is consistent with:

    29.1 the intended policy of the CCCFA at the time it was enacted, as evidenced by background material produced at the time.

    29.2 the Commission's draft Credit Fee Guidelines; and

    29.3 the decision in *Sportzone & MTF*.[5]

30. We think the *Sportzone & MTF*[6] decision goes a long way towards clarifying the fees provisions in a way consistent with Parliament's intention, and in a way that provides creditors with certainty as to their fees practices. However, that decision is currently under appeal, so its status in law remains uncertain. As the principles adopted by the Court in *Sportzone & MTF*[7] are consistent with the intended policy of the CCCFA when it was first enacted, we suggest that those principles should now be explicitly entrenched in the drafting of the CCCFA.

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[5] Ibid.
[6] Ibid.
[7] Ibid.

Commerce Commission* v *Sportzone & MTF

The Commission filed proceedings against Sportzone and Motor Trade Finance (MTF) in 2009. The Commission alleged that various fees charged by Sportzone and MTF were unreasonable. MTF had taken an approach where they recovered 100% of their business costs through fees. For example, MTF sought to recover the following costs in its establishment fee:

- marketing;
- business and product development;
- funding costs (which included costs arising from MTF's securitisation programme, short term bank facilities and capital contributions);
- general governance costs (including the director's remuneration);
- contingent debts; and
- IT production.

The Commission's view was that the fees that contained these costs were unreasonable as these costs were not directly related to the specific transaction that gave rise to the fee (which included the establishment of the loan).

The Court released its decision on 27 September 2013. The Court held that the fees challenged by the Commission were unreasonable. The Court held that the costs that a creditor recovers through fees must be "closely relevant" to the specific transaction that gave rise to the fee.

The Court stated:

> …an inquiry into unreasonableness in respect of a credit fee other than an establishment fee, or a default fee, is also transaction specific.

and

> Bearing in mind the statutory purposes identified and the focus of the statutory wording upon particular transactions….to be reasonable, the cost the creditor seeks to recover must be sufficiently close and relevant to the establishment of the particular loan, to the administration and maintenance of the particular loan, or to the actual consequences of the particular default, such that it can reasonably be said that the cost was incurred in connection with or in relation to the relevant matter.

On 25 October 2013 MTF and Sportzone filed an appeal in relation to that decision.

This case has cost the Commission in excess of $1,600,000 to litigate so far with the further costs of appeal yet to come.

The Act should be clear about whether creditors can recover opportunity cost through fees

Issue

31. It is not clear from the Act, or from the Bill, the extent to which a creditor can recover opportunity cost through fees. A lack of clarity on this issue creates uncertainty for business and reduces the effectiveness of compliance and enforcement outcomes. Creditors have referred to a return on capital as the portion of profit that they believe is legitimately recoverable through fees. The Commission otherwise understands that profit (except for potentially the 'opportunity cost' portion) is only recoverable through the interest rate.

Recommendation

32. We recommend that Parliament clarifies whether creditors are able to recover opportunity cost through fees. We suggest that it could do this by defining "costs" to include or exclude opportunity cost.

Reasons

33. One issue the Commission has grappled with over the years is whether the fees provisions allow a creditor to recover opportunity cost through fees. By opportunity cost we mean the benefit the creditor forgoes in order to lend to the debtor, eg, if the creditor could have earned a return of 5% on its capital investment in some alternative investment, then it would not be willing to invest in its current credit business were it not expecting a return of at least that amount. As such, a return up to 5% can be treated as a cost, or more specifically, an opportunity cost.

34. The issue has been framed in a variety of ways using a variety of terms, the meaning of which is not always clear.

    34.1 The Commission attempted to provide some guidance on this question in its draft Credit Fees guidelines, published in 2010. In these draft guidelines, the Commission stated:

    > A reasonable return on capital/cost of capital in relation to the assets and working capital attributable to the matter giving rise to the fee may be recovered.

    34.2 A number of creditors in their submissions responding to our draft Credit Fee Guidelines said they considered a "reasonable" fee should allow for the inclusion of a profit margin, and that this was consistent with the economic approach to costs.

    34.3 We note a return on capital is recoverable in other regulated industries as part of a reasonable return on investment.

35. In our view *Sportzone & MTF*[8] provides some guidance on the question of the recovery of opportunity cost through fees. The judgement states that fees must be

[8] Ibid

closely relevant to the "matter giving rise to the fee" [9] or the specific transaction. While it is conceivable that opportunity costs are specific to a particular transaction, especially for major or one-off transactions, we consider this atypical. Moreover, reflecting this cost in the vast majority of day-to-day loan transactions is likely to reduce the transparency and comparability of credit products for consumers. This is because creditors are likely to assess a return on investment in different ways and the amount of their fees will vary depending on how they do this.

36. The above also suggests recovery of such a cost through fees will present enforcement difficulties for the Commission; it would make determining the true cost of a loan, and determining whether the opportunity cost is in fact transaction specific, that much more difficult.

37. In addition, as noted above, the *Sportzone & MTF* [10] decision is under appeal, so the status of the guidance it provides remains uncertain.

38. This is an area where the Commission seeks clarity. We suggest that Parliament clarifies whether creditors are able to recover opportunity cost. We suggest that it could do this by defining "costs" to include or exclude opportunity cost.

Commerce Commission Draft Fee Guidelines

In May 2010 the Commission took steps to provide guidance to market participants on the fee provisions by developing draft fee guidelines. We included a statement that the Commission did not consider creditors could make a profit through fees (although the Commission stated that a creditor may be able to recover a return on investment). The Commission called for submissions on these guidelines and received the following feedback from one stakeholder:

> A "reasonable" fee should allow for the inclusion of a profit margin. This is a reasonable standard of commercial practice and is consistent with the economic approach to costs, an approach that has not been expressly excluded by the legislature in relation to credit and default fees and is endorsed by commentators on the issue.
>
> The notion that any profit (revenues exceeding accounting costs) can only be earned from interest charges, and not from fees, should not be adopted. This approach is not a feature of the CCCFA and reflects a simplistic approach to credit arrangements which the CCCFA has expressly sought to avoid.

[9] Ibid at [40] and [66]

[10] Ibid.

We support the proposed split of section 44

39. The Bill proposes that the current section 44, which regulates "other" credit fees and default fees be separated into two sections: "other credit fees" (proposed section 44) and "default fees" (proposed section 44A).

40. We support this proposal. It reflects our experience and view that these fees are quite different. Default fees typically recover a creditor's loss on default (ie, on breach of the contract), while other credit fees typically recover the creditor's costs relating to the specific matter giving rise to the fee (ie, in accordance with the contract).

Parliament should either remove or confirm the effect of the "reasonable standards of commercial practice" test

Issue

41. The current requirement for a Court to take into account "reasonable standards of commercial practice" has been difficult to apply in practice and does not provide certainty for creditors about the effect this standard has on their fees.

Recommendation

42. We support the proposal to remove the reasonable standards of commercial practice test, but if it were to be retained, we would recommend making it clear that this is intended as a factor that places a limit on what might be a reasonable fee.

Reasons

43. Currently, when assessing the reasonableness of an "other" credit fee or default fee, a Court is required to take account of "reasonable standards of commercial practice". The Bill proposes to remove this as a factor in assessing the reasonableness of "other" credit fee or default fees.

44. We have previously submitted to officials that this standard has been difficult to apply in practice and that it should be removed. In particular it has not been clear whether it is:

    44.1 a limiting factor (ie making fees unreasonable that otherwise reasonably compensate the creditor); or

    44.2 an accommodating factor (ie making fees reasonable that otherwise exceed the amount required to compensate the creditor).

45. In our view the *Sportzone & MTF*[11] decision suggests that "reasonable standards of commercial practice" is a limiting factor. Toogood J stated:[12]

> The Court is required under s44(1)(b) to have regard to reasonable standards of commercial practice. This requirement does not shift the inquiry away from a consideration of the

[11] Ibid.

[12] Ibid at [43]

particular fee charged in particular case; it indicates that the Court's inquiry as to reasonableness in the particular case will be informed by what is regarded as reasonable in general commercial practice.

Default fee investigation

In November 2007 the Commission commenced an investigation into default fees charged by credit card issuers including banks. The banks were charging fees of $20 to $25 where a debtor missed a payment. The investigation disclosed that all of the banks struggled to justify the fees on a cost-recovery basis, and some banks justified the fees on the basis that they were recovering costs associated with bad or doubtful debt, and costs associated with credit risk. A number of banks also claimed that they were entitled to recover an amount to deter debtors from defaulting and that this was a "reasonable standard of commercial practice".

The Commission's view was that the fees were unreasonable and the "loss" calculated by the banks did not accord with common law principles. The Commission elected to resolve the investigation in 2010 by issuing a compliance advice letter to the issuers stating that a late payment fee of $15 or below would not trigger the Commission's criteria for enforcement action. Our reason for resolving the investigation in this way was partly due to the litigation risk of taking proceedings under s44 and partly in order to achieve a quick change to industry practice.

There is now a clear statement in *Sportzone & MTF* that a fee incorporating an amount representing a deterrent element will be unreasonable (albeit because it would not meet the "closely relevant" test). However, we note that the decision is under appeal. We submit that the *Sportzone & MTF* reasoning should be entrenched in drafting amendments to the Act. If the Bill does not do this, the Commission may still need to litigate to obtain certainty.

We suggest that Parliament considers further amending the prepayment provisions

Issue

46. The prepayment provisions have been a particularly problematic area of enforcement for us. We support the proposed amendments but have concerns that compliance and enforcement will continue to be an issue in two areas:

    46.1 the amendments proposed may have created an unintended loophole allowing unregulated prepayment fees to be charged on variable interest rate loans.

    46.2 it is exceptionally difficult to assess the reasonableness of prepayment fees under the law as it stands. Given the multiplicity of prepayment fee methods, the Commission would need to take a myriad of court proceedings to build up a body of case-law sufficient to provide the level of certainty required to enable effective compliance and enforcement.

Recommendation

47. We suggest that Parliament should consider further amending the prepayment provisions in two ways:

 47.1 amend sections 44(2)(b) and 51(1)(c) to make it clear that a creditor may not recover a fee representing its purported loss on prepayment of a variable rate loan; and

 47.2 clarify how creditors should calculate a reasonable estimate of loss on full prepayment of a fixed rate loan.

Reasons

<u>Creditors should not be able to recover loss on prepayment of a variable rate loan</u>

48. We support restricting the recovery of prepayment fees (representing a creditor's reasonable estimate of loss) to fixed interest rate loans. In our view this is what was always intended, as creditors do not suffer loss when a variable rate loan is prepaid (on the assumption they are able to relend the repaid money immediately).

49. We are concerned though that this amendment will create an unintended loophole that will allow creditors to charge unregulated prepayment fees on variable rate loans. This is because, on one interpretation of the proposed language, a fee payable on prepayment of a variable rate loan or a fee that does not arise from early prepayment or from a difference in interest rates is:

 49.1 not prohibited by proposed section 43 (clause 25 of the Bill); and

 49.2 otherwise unregulated by the Act, as it may not fall within the definition of any of the fees regulated by the fees provisions, because the proposed section 44 does not apply to "fees payable on a full or part prepayment of a consumer credit contract".

50. If Parliament intends to prohibit creditors charging fees representing an estimate of a creditor's loss on variable interest rate loans, we believe there should be amendments to sections 44 and 51. Sections 44(2)(b) and 51(1)(c) should refer to "prepayment fees". We also think that section 43 should be amended so that it does not apply to administrative costs.

<u>How should creditors make a reasonable estimate of their loss?</u>

51. In our experience, not many creditors currently use the safe harbour formulae. Prepayment fees now differ significantly across otherwise similar credit products. Different creditors are using different formulae to calculate prepayment fees on fixed rate loans (some use retail interest rates, some use wholesale interest rates, and some refer to the creditor's profit margin). We are aware of cases where fees calculated using wholesale interest rate formulae are as much as three times higher than fees calculated using the safe harbour formulae.

51.1 Procedures for calculating a reasonable estimate of loss are complex and not always transparent for debtors. Some involve inputs such as wholesale interest rates that are not publically available, fluctuate all the time, and in some cases, can actually be set by the creditors themselves. With these sorts of formulae, debtors:

51.1.1 are not easily able to compare the cost of prepayment across credit products; and

51.1.2 are not able to easily ascertain the cost of prepayment at any given time, including (especially) when committing to the debt.

This may affect debtors' inclination to prepay even in circumstances where it would benefit them.

51.2 It is exceptionally difficult to assess the reasonableness of prepayment fees under the law as it stands. Given the multiplicity of prepayment fee methods, the Commission would need to take a myriad of court proceedings to build up sufficient case-law to guide compliance.

52. We understand that the policy behind the prepayment provisions was intended to modify the common law and that the safe harbour formulae[13] were templates for an "appropriate procedure" for calculating a creditor's reasonable estimate of loss on full prepayment.[14] In our view the policy was that creditors would adhere to the principles inherent in the formulae that:

52.1 a creditor does not suffer loss on early prepayment of a variable interest rate loan;[15]

52.2 a creditor may suffer a loss on the early prepayment of a fixed rate loan, and this loss arises from movements in retail interest rates (ie, the difference between what the creditor can now lend money at, compared to the prevailing rate when the original loan was advanced[16]);

52.3 that the loss will be calculated assuming the outstanding balance would be reduced over the remaining period of the loan;[17]

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13 The safe harbor formulae is the formulae set out in clause 9 and 11 of the Credit Contract and Consumer Finance Regulations 2004. The amount calculated using these formulae is deemed to be a reasonable estimate of loss under section 54 of the Act.

14 *Consumer Credit Law Review – Part 3: Transparency in Consumer Credit: Interest Fees and Disclosure* p44 and Appendix One;

15 Ibid at p43 and Appendix One;

16 Under the Safe Harbour Formulae, if the interest rate were higher at the time of prepayment compared to the time the loan was entered into (and given the assumption that the creditor can relend the money immediately), then the creditor would be better off as a result of prepayment, and so is not able to seek any fee for loss.

17 Assuming payments on the loan include a principal component.

52.4 any formulae should make allowance for the time value of money (ie, that if a creditor receives repayment of the loan today, that is worth more than receiving it in say, one years' time); and

52.5 any formulae should assume that the creditor can relend the money immediately.

> ***Commerce Commission v Avanti***
>
> In early 2006 the Commission commenced an investigation into early repayment fees charged by Avanti. The Commission was concerned that Avanti had not made any attempt to mitigate its loss by relending when debtors repaid their loans early. The Commission commenced criminal proceedings against Avanti in 2007. The matter was heard in the District Court in June 2008 and the Court found that there was no general duty to mitigate loss by relending. The Commission appealed and the appeal was heard in the High Court in 2009. Again, the Commission was unsuccessful and the Court confirmed that creditors were not under an obligation to mitigate their loss in all circumstances by relending monies prepaid. The High Court held that the common-law approach to loss was relevant in determining a reasonable estimate of loss on full prepayment. The Court suggested that compliance with the common-law principles would result in a reasonable estimate of loss.

53. If a common law approach and the use of formulae that depart from the safe harbour is not what Parliament intended, then the Act should be clarified. Parliament could consider:

53.1 explicitly setting out the principles that should be followed when calculating a reasonable estimate of loss;

53.2 capping prepayment fees at a proportion of the loan amount;

53.3 simply requiring creditors to use the formulae set out in the Credit Contract and Consumer Finance Regulations 2004. They would no longer be a safe harbour but prescribed formulae.

Remedies and Offences

Overview of issues

54. In our experience as an enforcer of consumer protection statutes, effective remedies and penalties are essential to ensuring compliance with the law. We have some concerns that the current proposals are not sufficient to ensure compliance.

54.1 Creditor compliance with the repossession and Lender Responsibility Principles (LRPs) is essential as real harm can flow from contravention. Criminal and civil remedies will help deter creditors from breaching these provisions.

54.2 Some obligations are imposed in the Bill without a corresponding sanction in each case.

55. We think there is a need for more incentives to encourage creditors to comply with the Act and greater financial consequences if they do not. We are optimistic that the proposed changes to the Act, the introduction of the LRPs and the incorporation of provisions relating to credit repossession will help the Commission curb undesirable lending practices and will help protect debtors.

56. We discuss in more detail below those areas where we consider the proposed criminal and civil sanctions are not sufficient to promote compliance, together with our specific recommendations and the reasoning in support of those recommendations.

Non-compliance with repossession provisions should be an offence

Issue

57. We have frequently encountered creditors who do not understand their obligations for the conduct of repossessions and who routinely breach the law. The behaviour of these creditors is unlikely to change in the absence of a more effective enforcement toolkit.

Recommendation

58. We recommend that the Bill makes it an offence to repossess consumer goods other than in accordance with the Act.

Reasons

59. In our experience of talking to debtors, repossession can be a very stressful and invasive process. We have frequently encountered creditors who do not understand their obligations and who routinely breach the law as it relates to repossession. Where the creditor has engaged in misleading and deceptive conduct, we have prosecuted under the Fair Trading Act 1986 (Fair Trading Act). However, not all offensive repossession practices involve misleading conduct.

60. Under the Bill, it will not be a criminal offence to breach the majority of the provisions of Part 3A. This means that we will only be able to take enforcement action against creditors for breaching the repossession provisions if they have caused loss or damage to debtors. We consider that all non-compliance with the repossession provisions should be an offence under the CCCF Act. Currently there are insufficient incentives for creditors to comply with the repossession provisions of the Bill. In our view it should be an offence to repossess consumer goods other than in accordance with Part 3A of the Act.

61. The Law Commission in their review of the Credit (Repossession) Act 1997 did not recommend including criminal offences for post-repossession breaches. Their reasons for this recommendation included:

> [Post repossession requirements] are not the type of requirements that can be easily enforced by the Police, given that they relate to the issuing of notices within particular timeframes, the sale and valuation of consumer goods and the reinstatement of agreements.

62. While not easily enforceable by the Police, post-repossession provisions are readily enforced by the Commission and fit well within our current functions under the Act. In particular, the Commission is set up to receive complaints and already investigates allegations of disclosure breaches which, in part, relates to issuing notices within particular timeframes. The Commission already considers sale processes and valuations in the context of Fair Trading Act investigations.

63. The Commission has successfully prosecuted for breaches of the Credit (Repossession) Act 1997 via section 13(i) of the Fair Trading Act. If breaches of the Part 3A provisions, on their enactment, give rise to criminal liability under the Fair Trading Act, it seems incongruous for them not to give rise to an offence under the CCCF Act.

64. In this respect, the Bill is not consistent with the approach in Australia. Under the National Consumer Credit Protection Act 2009 (NCCP Act), breaches of both "pre-possession" and "post-possession" obligations are criminal offences.[18]

Non-compliance with the Lender Responsibility Principles should be an offence

Issue

65. The Bill does not propose to penalise creditors for breaching the LRPs. It only allows the Court to make order to compensate debtors for loss or damage. Our experience suggests that the prospect of simply having to refund money received as a result of conduct that breaches the Act, is unlikely to impose sufficient incentives to ensure high levels of compliance across all categories of creditors.

Recommendation

66. We recommend the LRPs should give rise to criminal offences or, at least, to civil penalties.[19]

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18 The NCCP Act refers to "pre-possession" and "post-possession" obligations.

19 We accept that a breach of section 9B(g) should not give rise to a criminal offence in so far as the creditor's conduct breaches the Fair Trading Act 1981. Breaches of the Fair Trading Act already give rise to criminal offences under that Act.

Reasons

67. The ability to lay criminal charges or to apply for civil penalties for contraventions of the LRPs will encourage compliance and will provide a timely and cost-effective enforcement mechanism. The Bill does not propose to penalise creditors for breaching the LRPs. They may be required to refund money that they should not have obtained in the first place, or they may be required to pay compensation or damages to debtors who have suffered loss or damage as a result of the creditor's behaviour. But, in our view, these do not amount to a real incentive to comply with the LRPs.

68. There are penalties for breaching the LRPs in the Australian NCCP Act, and we understand from the enforcement organisation Australian Securities and Investment Commission (ASIC) that they find these penalties useful in encouraging compliance with their Act.

The current level of penalties is insufficient to promote compliance

Issue

69. Current penalties are not sufficient to deter some creditors from breaching the Act. We are concerned that some creditors consider breaches of the Act to be a cost of business and some creditors come to attention more than once in relation to possible breaches of the Act.

Recommendation

70. We recommend bringing current penalties in line with other New Zealand and Australian consumer protection statutes. This would provide a more effective deterrence to creditors contemplating breaching the Act.

Reasons

71. We think the penalties are too low and are out of step with other New Zealand and Australian consumer protection statutes. The maximum penalty available under the Act is $30,000 and it has not changed since the Act was passed. This can be compared to penalty regimes under other statutes in New Zealand and Australia as follows:

    71.1 Penalties for breaching the Fair Trading Act are set to increase under the Consumer Law Reform Bill to a maximum of $200,000 for an individual and to a maximum of $600,000 for a company.[20]

    71.2 The Securities Act criminal penalties are $300,000 + $10,000 for every day that the offence is continued. The civil pecuniary penalties are a maximum of $5 million for a company and $500,000 for an individual.[21]

    71.3 The Financial Markets Conduct Act's penalties are as follows:

[20] Consumer Law Reform Bill Clause 22.

[21] Securities Act 1978 section 58, 59 and 60. The Securities Act 1978 is set to be repealed by the Financial Markets (Repeals and Amendments) Act 2013.

71.3.1 for misleading and deceptive conduct 5 years imprisonment or $200,000 fine or both.[22]

71.3.2 where a person knowingly or recklessly contravenes provisions relating to defective disclosure the penalty is $500,000 and 5 years imprisonment and $2.5 million in all other cases.[23]

71.3.3 where a person makes a securities offer where they know or are reckless as to whether the statement is false or misleading, the penalty is $1 million or 10 years imprisonment in the case of a contravention by an individual or $5 million in any other case.[24]

71.3.4 For other civil liability provisions, the penalty is $200,000 for an individual and $600,000 for a company.[25]

71.4 Maximum pecuniary penalties for non-compliance with the Australian NCCP Act are A$220,000 for an individual and A$1.1 million for a company.[26]

71.5 The Australian Consumer Law also has maximum penalties of A$1.1 million for a company and A$220,000 for an individual for misleading and deceptive conduct.

72. We are concerned that current penalties are not sufficient to deter some creditors from breaching the Act. In the 2011/2012 year, for example, we found that 16% of cases under the Act where we had issued an enforcement response under the Act were committed by businesses against whom the Commission had delivered more than one enforcement response in the last three years.[27]

Statutory damages are too low

Issue

73. We consider that the effectiveness of the statutory damages regime has been compromised to the point where applying for statutory damages is hardly worthwhile for debtors, or for the Commission on behalf of debtors.

Recommendation

74. We recommend the minimum amount of statutory damages should be increased in order to encourage debtors to take their own action and to encourage creditors to comply with the disclosure provisions.

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22 Financial Markets Conduct Act section 512.

23 Financial Markets Conduct Act section 511.

24 Financial Markets Conduct Act section 510.

25 Financial Markets Conduct Act section 90.

26 For example NCCP 2009 section 167 and National Credit Code clause 29.

27 Our enforcement responses include compliance advice letters, warnings, settlements and criminal and civil Court Act. The Commission's enforcement response guidelines can be found at http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/.

Reasons

75. Statutory damages are an amount payable to an affected debtor on breach of the Act by a creditor. They form part of a penalty regime that was effectively transferred to the Act from the Credit Contracts Act 1981. They are available for breaches of the disclosure provisions and are set at a low level.

76. For the majority of disclosure breaches, the maximum amount of statutory damages is the lesser of $3,000 or 5% of the total loan advances with a $100 minimum. If the creditor has breached more than one provision of the Act, the statutory damages are limited to the highest amount payable for one breach. The Commission has to take Court action (whether criminal or civil) in order to obtain an order for statutory damages.

77. Statutory damages are currently not set a level that encourages debtors to take their own action for breaches of disclosure provisions. A debtor who has not received appropriate disclosure would need to have a loan of over $2,000 in order to obtain statutory damages of over the $100 minimum. They would also need to seek an award of statutory damages from the Disputes Tribunal. From our experience of speaking to debtors, that rarely happens.

78. The Commission rarely applies for statutory damages for two reasons. One is that the current levels are minimal and secondly, the Commission rarely takes proceedings where there have only been breaches of the disclosure provisions. This is because the cost of taking a proceeding solely to obtain an order for statutory damages would typically exceed the award of damages. In our view the statutory damages regime needs a significant overhaul to make it an effective compliance tool.

Infringement notices should be introduced for breaches of disclosure provisions

Issue

79. We do not currently have a cost effective and timely, enforcement mechanism in our enforcement toolkit.

Recommendation

80. We recommend that the Commission be given powers to issue civil infringement notices for breaches of the disclosure provisions (ie sections 17 to 26) and for breaches of Part 3A relating to repossession.

Reasons

81. Infringement notices would assist us in achieving compliance by providing a fast and cost effective way of censuring conduct that breaches the Act, and by holding creditors publicly accountable for their actions.

82. Many of the offences in the Act could appropriately be dealt with by infringement notice. Breaches of the disclosure provisions are strict liability, usually clear-cut and easy to establish. We anticipate that most of the Part 3A breaches will be in the same category. However, the cost of taking Court action to establish breaches of

these provisions is high. Criminal prosecution is time consuming and expensive with even undefended matters costing many thousands of dollars. Infringement notices would be a low-cost, quick and proportionate way of dealing with easily identifiable breaches of the disclosure provisions of the Act without criminalising the creditor (as infringement notices are not a criminal offence). We would of course continue to take criminal proceedings in appropriate circumstances.

83. Infringement notices are already used successfully in Australia for credit-related offences and they are set to be introduced in New Zealand for some Fair Trading Act breaches. They are widely used in other areas particularly in fisheries, environmental and industrial regulation. We see benefits in aligning New Zealand's consumer credit law with Australia's and also in making the same enforcement tools available to the Commission throughout the consumer law area.

84. ASIC has the ability to issue infringement notices under the Australian NCCP Act as an alternative to commencing a criminal prosecution or a civil penalty action. ASIC has advised us that they find infringement notices a useful compliance tool. They find that they obtain much quicker outcomes than they do using other enforcement tools. This allows ASIC to take enforcement action for breaches that are less serious but still warrant a penalty. If infringement notices were not available, these breaches either would not be able to be dealt with or might otherwise require disproportionately costly court proceedings to resolve.

85. ASIC advises that they have internal checks and balances to ensure that infringement notices are properly used. They issue notices where they consider they have sufficient evidence of an offence to take penalty action. They also do not publicise the fact that they have issued an infringement notice but they do publicise when a notice is paid. We anticipate adopting similar safeguards if infringement notices were to be introduced here.

86. We also note that the Commission will be able to issue infringement notices with the enactment of the Consumer Law Reform Bill. We anticipate that there would be policy and operational synergies for the Commission if infringement notices were introduced as part of the proposed amendments to this Act.

All obligations should have a corresponding sanction

Issue

87. There are sections in the Bill that place important obligations on creditors but there are no consequences for creditors if those obligations are not met.

Recommendations

88. We recommend that enforceable sanctions are introduced for failure to comply with proposed sections s7A, 9H and 9G.

Reasons

89. The Bill places a number of important obligations on creditors that are not subject to any sanctions if those obligations are not met.

89.1 Clause 8 of the Bill proposes a new section 7A which forbids creditors from taking a security interest over particular categories of consumer goods.

89.2 Clause 9 proposes new sections 9H and 9G which require creditors to publish their standard conditions and costs of borrowing.

90. There is currently no sanction prescribed (civil or criminal) for creditors who do not comply with these obligations and accordingly, it will be difficult to take legal action against creditors if they breach these provisions.[28]

91. In the Fair Trading context we have found that offence provisions provide an effective method of promoting compliance. The Commission considers that it is important that creditors are incentivised to comply with these obligations.

The offence of obstructing a creditor lawfully repossessing goods should be removed

92. We are reluctant to be the body responsible for enforcing the offence of forcibly or wilfully obstructing a creditor lawfully repossessing goods (clause 58 section 103(1A). In our view this provision is at odds with the overarching consumer protection purpose of the Act. Commission staff are not trained to deal with situations involving obstruction or disturbance of the peace. We consider that, if such an offence is retained, it would be best enforced by the Police.

The Bill should make it clear that creditors should be liable for actions of agents

93. Creditors commonly outsource parts of their lending function (for example, brokers often undertake the application for credit, repossession agents undertake the tasks of repossession) and it is unclear what, if any, liability attaches to the creditor if the agent contravenes the Act. In our view it would be appropriate to include a section similar to section 45 of the Fair Trading Act which sets out provisions relating to the attribution of knowledge of directors, servants or agents of the company to the company itself.

Scope

The Bill should clarify which contracts are “credit contracts”

Issue

94. There is a lot of uncertainty about what types of arrangements are captured by the Act and that uncertainty is not addressed by the Bill.

Recommendation

95. We recommend that the definitions of “credit contract” and “credit fee” are reviewed to remove any unintended application of the Act.

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[28] We may be able to establish that a creditor has breached the LRPs by failing to comply with these provisions (see proposed s9(g)) but we will still only be able to seek Court orders where debtors have suffered loss or damage.

Reasons

96. The current definition of “credit contract” includes any contract under which payment of an amount owing is deferred. Gym memberships, utility bills, contracts (such as phone contracts) that include the purchase of an item as well as the provision of services, together with other contracts of service, particularly where there is a minimum subscription period (eg, pay television), may fall within the scope of the Act. Many of these contracts will be consumer credit contracts if the creditor charges a “credit fee” or interest.

97. The definition of “credit fee” is extremely broad and, in our view, is likely to cover joining fees, administration fees and termination fees. Once caught by the Act, parties offering these types of contracts are required to comply with the disclosure, fees, responsible lending and oppression obligations and therefore face associated compliance costs. They are also subject to cancellation provisions and the provisions relating to reasonable fees (among others). The type of contracts that in our view may be consumer credit contracts include:

    97.1 contracts with funeral directors where payment is deferred;

    97.2 portrait photos where the payment is deferred;

    97.3 dentist or orthodontist bills where the payment is deferred;

    97.4 private school fees;

    97.5 golf club memberships; and

    97.6 gym memberships.

98. Despite 10 years of enforcing the Act it is not clear to us whether Parliament intended to capture some of these transactions. If Parliament does not intend for the Act to apply to these contracts, we submit the Act should be amended to make this clear.

The debtor’s purpose in obtaining credit should determine whether a contract is a consumer credit contract

Issue

99. The Bill proposes that it will be the creditor’s purposes in providing credit that is relevant in determining whether a credit contract is a consumer credit contract. This has the potential to create unnecessary enforcement difficulties and water down the presumption that a contract is a consumer credit contract.

Recommendation

100. We recommend that the proposed amendment to s11 is removed from the Bill.

Reasons

101. We think that the debtor's purpose in obtaining the credit should determine whether the contract has been entered into predominantly for personal, domestic or household purposes. The Bill proposes to replicate the Australian NCCP Act and amend section 11 of the Act to make the creditor's purpose in providing credit determinative of whether the contract is a consumer credit contract, rather than the debtor's purpose in entering into the contract (as is currently the case). Although the creditor will need to provide evidence of their purpose in providing credit under section 13, in our view the change will create unnecessary enforcement difficulties and will water down the effectiveness of the presumption in section 13.

102. The law in Australia is unsettled as to how the purposes test should be applied. In some cases the Courts have considered what a reasonable person standing in the shoes of the credit provider would have understood to be the predominant purpose for which the credit was provided.[29] This involves taking into account the information communicated by the consumer to the credit provider prior to and at the time the credit contract was entered into. In other cases the Courts have been concerned with the substance of the transaction, that is the way the credit provided under the credit contract was ultimately used (which is generally the approach required with the current test).[30]

The repossession provisions should apply to consumer credit contracts

Issue

103. The Bill does not apply seamlessly throughout the life of a consumer credit contract. This inhibits the smooth application of the law and is likely to exacerbate problems that arise with enforcement of the Act. Part 2 provisions that relate to disclosure, payment, interest and fees apply to a different class of contracts than the repossession provisions.

Recommendation

104. We recommend that Part 3A of the Act is amended to apply to all consumer credit contracts regardless of the nature of the collateral. We suggest that the test for whether goods are consumer goods should be the purpose for which they were acquired at the time they were acquired.

Reasons

105. Part 2 of the Act applies depending on the purpose for which credit has been provided. However, Part 3A only applies to credit contracts secured over consumer goods. Some consumer credit contracts will not be covered by those provisions. For example, consumer credit contracts that are not secured over consumer goods even

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[29] *Rafqi & Anor* v *Wacai Investments Pty Ltd* [1998] ASC 1550-024, Brabazon DCJ, *Park Avenue Nominees Pty Ltd* v *Boon (on behalf of Weir) & Anor* [2001] NSWSC 700); *Taylor & Taylor* v *Third Szable Holdings Pty Ltd* [2001] VCAT 1841 at 59-64.

[30] *Linkenholt Pty Ltd* v *Quirk* [2000] VSC 166 at [98] *Jonsson* v *Arkway Pty Ltd* (2003) 56 NSWLR 451, *Bahadori & Ors* v *Permanent Mortgages & 3 Ors* [2007] NSWSC 79, *Knowles* v *Victorian Mortgage Investments Ltd & Anor* [2011] VSC 611.

though the debtor's purpose in obtaining the credit is predominantly personal will not be covered.

106. Consumer goods are defined in the Bill as "goods that are used or acquired for use primarily for personal, domestic or household purposes". It appears arguable that even where secured goods were initially intended to be used for personal domestic or household purposes, if their actual use changes this may change a creditor's obligation to comply with the repossession provisions. It is likely that the Commission would need to take litigation to resolve this issue.

Examples of how the Bill may apply in particular circumstances

A person enters into a loan contract, uses a motor vehicle as security for the loan and the motor vehicle is specifically identified. If that person:

1. borrows the money to purchase the motor vehicle which is to be used for personal purposes:
    a. the contract is a consumer credit contract; and
    b. a creditor must comply with part 3A repossession requirements.

2. borrows the money to pay for a funeral and the motor vehicle is a taxi:
    a. the contract will be a consumer credit contract; and
    b. the creditor does not need to comply with part 3A repossession requirements.

3. borrows the money to purchase the motor vehicle and the vehicle is initially intended to be used for personal purposes but is subsequently used as a taxi:
    a. the contract is a consumer credit contract; and
    b. the creditor may <u>not</u> need to comply with part 3A repossession requirements.

Parliament should clarify when the repossession provisions apply

Issue

107. The Commission is concerned that a creditor could avoid the operation of the repossession provisions by failing to specifically identify consumer goods in the contract or by failing to provide variation disclosure.

Recommendation

108. We recommend that the creditor's obligation to specifically identify consumer goods in a security agreement and to provide variation disclosure apply to restrict the circumstances in which a creditor can repossess consumer goods rather than whether the repossession provisions apply.

Reasons

109. This issue arises because part 3A only applies where:

109.1 the consumer goods are specifically identified in the credit contract; or

109.2 the consumer goods subject to the security are acquired after the contract has been entered into, and:

109.2.1 those goods have been specifically identified in the credit contract; and

109.2.2 the parties have agreed to change the contract to specifically secure those goods; and

109.2.3 the creditor has given variation disclosure.

110. In our view section 83(2) appears to be designed to require creditors to specifically identify goods and to provide variation disclosure in appropriate circumstances. This would assist debtors to understand exactly what they stand to lose if they default under the credit contract. Our concern is that under the current drafting, these are not prerequisites to repossession but are prerequisites to the application of part 3A. This means that debtors who have loans secured over consumer goods stand to lose the part 3A protections due to factors that are within the creditor's control.

The Act should prohibit the charging of undisclosed credit fees

111. There is no prohibition on charging a credit fee that has not been disclosed. The Commission has previously encountered creditors charging undisclosed credit fees but we have been required to take action under the Fair Trading Act in order to capture this type of conduct.[31]

The Act should be clearer about how it applies to Pawnbrokers

Issue

112. The proposed amendment to section 10 as it relates to pawnbrokers is not clear and we are concerned that it will exclude all pawnbroking transactions from many of the significant provisions of the Act.

Recommendation

113. We recommend that the Bill exempt pawnbroking transactions from Part 2 of the Act where the pawnbroker's only remedy is to sell the goods.

Reasons

114. Pawnbrokers are currently required to comply with Part 2 of the Act. They are also required to comply with the provisions of the Second Hand Dealers and Pawnbrokers Act 2003 (SHDP Act).

115. We are aware that there has been some concern about possible conflict between the two pieces of legislation. We understand that it was expected that the Bill would

[31] *Commerce Commission* v *Budget Loans Limited* [DC AK Notes of Judge DM WIlson QC on Sentencing (Orally) 26 July 2010 CRI 2009-004-028349].

exempt pawnbroking transactions from Part 2 of the Act in relation to loans where the pawnbroker's only remedy is to sell the goods. We are concerned that this is not necessarily the effect of the section.

115.1 Section 10 excludes from Part 2 of the Act "goods" that have been pawned in accordance with the SHDP Act. The Act does not apply to "goods". It applies to consumer credit contracts.

115.2 The exclusion applies where the pawnbroker's only right of recourse is under section 63 of the SHDP Act. Section 63 of the SHDP Act allows (but does not require) a pawnbroker to sell pawned goods and to apply the proceeds against the debt. However, section 63 is silent about the pawnbroker's rights if there is a shortfall and accordingly, section 63 may not in fact limit the pawnbroker's right of recourse.

115.3 The exclusion may apply where the pawnbroker is entitled to sell the goods under section 63 but simply does not do so, allowing the pledge to run and continue to attract interest. In our view this is not likely to have been the intention when the exclusion was drafted.

There should be a separate right of cancellation for credit-related insurance, repayment waivers and extended warranties

Issue

116. We do not consider that the proposed regulation of credit related insurance, repayment waivers and extended warranties is sufficient. There is currently no right of cancellation or cooling off period for credit-related insurance or repayment waivers.

Recommendation

117. We recommend that the Act provide debtors a right to cancel a credit-related insurance product at any time during the term of the loan and receive a rebate.

Reasons

118. The Consumer Law Reform Bill proposes a right to cancel an extended warranty but that right will not apply "to an extended warranty agreement that has been entered into as a condition of a consumer credit contract".[32] In our experience debtors often find themselves irrevocably committed to expensive premiums at point of sale in circumstances where they have not been given an opportunity to shop around.

119. The Competition Commission (CC) in the UK published a report into Payment Protection Insurance (PPI) in 2009. That report noted:[33]

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[32] Consumer Law Reform Bill clause 18 proposed section 36U of the Fair Trading Act 1986.

[33] Competition Commission: Market investigation into payment protection insurance 29 January 2009 http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/542.pdf

> The vast majority of the UK's more than 12 million [payment protection insurance] policies are sold at the same time as a consumer takes out a loan, credit card or other type of credit. The CC found that many consumers: are unaware that they can buy PPI from other providers, rarely shop around to compare prices and terms and conditions of PPI policies, and rarely switch PPI providers. The resulting 'point-of-sale' advantage makes it difficult for other PPI providers to reach credit providers' customers and in the absence of such competitive pressure, consumers are charged high prices.

120. We note that the CC in the UK introduced a number of requirements for PPI as a result of its investigation in that area. This included a prohibition on creditors selling credit-related insurance products for seven days after providing the loan and a prohibition on providing single premium insurance policies.

121. There is currently limited regulation of credit-related insurance under the Act. It is not possible under the Act, for example, for a debtor to retain a loan but cancel the associated credit-related insurance product. We think that the Act should at least give debtors the right to cancel a credit-related insurance product at any time during the term of the loan and receive a rebate of the premium.

Better quality of information

Disclosure statements should be revised

Issue

122. In our experience the current disclosure requirements are not effective in providing more vulnerable consumers with easy access to key information about their loans.

Recommendation

123. We recommend that the model disclosure statements in the Regulations should be revised and made easier to read. We think that disclosure should be clear, simple and short, requiring disclosure of a summary of "key points".

Reasons

124. There has been comprehensive experimental research conducted in Australia (the UniQuest report) [34] which strongly suggests that their current disclosure requirements (that are similar to ours)[35] do not assist debtors to understand the cost of the loan.

125. The UniQuest report states:

> Comprehension tests indicate that consumers **do not understand** important features of consumer credit contract transactions after reading documents supporting those transactions which are compliant with the Code.

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[34] Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign — Final Report; Mr Paul O'Shea, Uniquest, 12 March 2010.

[35] Although we note the Australian disclosure regime under the NCCP Act, unlike ours requires creditors to provide a "financial table" before the debtor enters into the contract in addition to full disclosure requirements.

126. The key points arising out the research included that:[36]

    126.1 only 6% of participants understood the true cost of home loan credit using the CDM [Current Disclosure Model];

    126.2 using the CDM for credit cards only 15% of participants understood how long it would take to pay off their credit card limit making minimum monthly payments and only 10% could estimate how much interest that would cost; and

    126.3 29% of participants understood the total of interest charges on a car loan using the CDM but only 3% could find the restriction on repossession explained in the statutory information statement.

127. This reflects our experience that debtors do not understand the true cost of their loans.

128. The UniQuest report recommends the introduction of a new "Financial Summary Table"; a targeted and high-impact version of their existing financial table that is restricted to key pricing information and that includes an estimate of the overall cost of credit.

129. The UniQuest report also recommends product specific disclosure for home loans, credit cards, car loans, and store cards. We understand that the Australian Treasury is also considering introducing product-specific disclosure for reverse mortgages, consumer leases and personal loans.[37]

130. We would support the introduction of a similar disclosure model here.

131. At the very least, disclosure of the key information required by the Act (as set out in Schedule 1) should be required to be made in a single document. In our experience key information is sometimes hidden in the contract itself or is dispersed throughout a number of documents in a way that makes it hard for debtors to access the information (although not so as to manifestly breach the disclosure standards). Currently s32 (2) allows information to be disclosed in one or more documents. In our view it would be simpler to require creditors to provide a single "disclosure statement" to debtors. This would also assist enforcement.

There should be requirements about the advertising of interest rates

132. In our experience, debtors are confused by advertisements that refer to monthly, weekly or daily interest rates. In our experience debtors compare these headline rates favourably to annual interest rates charged by banks and other first tier lenders, when in fact they are significantly higher. We think consumers would be protected by a requirement that any advertisement referring to interest rates should

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[36] Above n34 at p54.

[37] Changes to Disclosure Requirements under the *National Consumer Protection Act 2009* Australian Government the Treasury Discussion Paper April 2013.

also refer (in near proximity) to the applicable annual interest rate in the same font size as any other rate advertised.

Advertising of Interest Rates

The Commission issued a compliance advice letter under the Fair Trading Act to a creditor who was advertising 8% interest when in fact the rate was a weekly interest rate. The annual interest rate was 416%.

There should be changes to the timing of disclosure of a contractual change

133. Currently a creditor is required to make disclosure of a change to a consumer credit contract within five working days of it taking effect. Consumers should be given the opportunity to consider the effect of the change to their credit contract and to exercise any rights of cancellation, prepayment or termination before the change takes effect. In our view, disclosure of a change following the exercise of a power under section 23(3) should be made prior to the exercise of the power on the customer giving an opt-out clause for a period following disclosure.

Clear and consistent language

We think that some language used in the bill is unclear and will give rise to enforcement difficulties

Issue

134. The Bill introduces new terms and concepts that appear to duplicate existing terms and concepts already in the Act, giving rise to uncertainty as to what relevant provisions mean, in particular why a different phrase has been used and how the meaning differs between phrases. The Bill also uses imprecise terminology. Both issues will have flow on effects to enforcement, in particular the likelihood that litigation will be required to develop a certain and known enforcement and compliance regime.

Recommendation

135. We recommend that the Bill contains consistent and clear language that enables the creditor to understand its obligations and comply with the Act.

Reasons - The Bill introduces new terms and phrases that are inconsistent with the Act

136. As a matter of statutory interpretation, a Court may conclude these new terms have a different meaning from other terms used in the current Act, otherwise why would the new and different terms have been used? This is likely to create uncertainty about what the provisions mean. For example, the Amendment Bill uses terms such as:

136.1 "lender's fees" (s9I) which appears to have a similar meaning to "credit fees" as defined in section 5;

136.2 "amount required to reinstate agreement" (section 83V), which seems to have a similar meaning to "unpaid balance and credit fees" as defined in section 5;

136.3 "other charges and reasonable costs and expenses" (section 83V), which seems to have a similar meaning to "credit fees";

136.4 "the amount of the costs and expenses of and incidental to the sale", (section 83ZC) which seems to have a similar meaning to "credit fees";

136.5 "the amount of arrears of instalments, including interest and other charges" (Schedule 3A) which seems to have a similar meaning to "unpaid balance"; and

136.6 "the creditor's estimate of the total amount required to be paid to reinstate the agreement" (Schedule 3B) which seems to have a similar meaning to "unpaid balance".

137. The Amendment Bill also introduces a concept of "cost of borrowing" into the Act. This concept that seems akin to the concept of the "cost of credit" used under the repealed Credit Contracts Act 1981 (CCA). Our records show that one of the key reasons for repealing the CCA was to move away from the concept of "cost of credit". This proposal seems to be an inadvertent reversion to that discarded concept.

138. In addition to "credit contract" and "consumer credit contract", "credit sales", "buy back transactions" and "consumer leases", the Amendment Bill now also refers to "arrangements" and "agreements".[38]

[38] Clause 9 proposed s9A, clause 63 proposed s124, clause 46 proposed amendments to s88, schedule 1 proposed schedule 1AA.

139. The Bill uses the terms “borrower” and “lender” in the LRPs, whereas the Act uses “debtor” and “creditor”. It appears the main reason for adding these new terms appears to be to ensure the LRPs apply to all transactions. However it is not helpful having new – but different –terminology for essentially the same parties.

140. We submit that this language should be made consistent.

Reasons - The Bill introduces terms that are imprecise

141. There are a number of areas where the provisions of the Bill (and particularly those relating to creditors’ obligations) are expressed imprecisely. Our experience tells us that concepts such as “reasonable” are malleable and can be interpreted in divergent ways to suit a party’s interests. The only way to obtain clear guidance on Parliament’s intention is to take Court proceedings. This could be avoided if the concepts were worded more precisely now.

142. We think the following terms are imprecise and should, wherever possible, be further defined:

142.1 LRPs: “responsible lender”, “reasonable inquiries”, “treat borrowers…reasonably”, “reasonable grounds to believe the information is not reliable”.

142.2 Section 9H and section 9I: “publicly available”.

142.3 Section 83C: “reasonable grounds”.

143. While some of the terms set out above may be clarified by the Lender Responsibility Code, we note the code will not be in place for two years after the Bill is passed. During this time the Commission may need to litigate in order to obtain clear guidance on the meaning of these terms.

The Bill should be more specific about what is meant by a “reasonable commission” on credit related insurance

Issue

144. Under section 45(5) the Bill requires insurance commissions to be “reasonable”. In order to allow the Commission to take effective enforcement action the Bill should provide clear guidance on what a “reasonable” commission on credit related insurance is.

Recommendation

145. We suggest that Parliament either cap commissions on credit-related insurance or repeal section 45(5).

Reasons

146. There is a divergence of opinion about what a “reasonable” commission is. During the course of our investigations some insurance providers have indicated that a

commission that is 100% of the premium is "reasonable". Others have suggested a proportion of the premium is reasonable. Without clear guidance in the Act, we think that it will be extremely difficult to obtain evidence to satisfy a Court that any commission is unreasonable.

147. In Australia commissions on credit-related insurance are capped at 20% of the premium.[39] A similar approach in New Zealand would provide certainty to industry and allow the Commission to enforce the standard effectively.

The Bill should clarify whether "interest" includes "default interest"

148. It is also not clear, under the current provisions of the Act, whether a credit contract that only provides for default interest is a consumer credit contract under the Act. It is arguable that default interest falls within the definition of "interest" under the Act but equally arguable that it does not. We suggest that references in the Act to interest should be amended to make it clear whether the reference is to ordinary interest (only) or default interest or both ordinary interest and default interest.

The Bill should clarify the creditor's obligation to provide continuing disclosure in particular situations

Issue

149. We have also had problems determining the scope of creditors' obligations where the creditor ceases to provide credit on a revolving credit contract (eg, a credit card) but where there is an outstanding debt and the creditor continues to charge interest and/or fees. In our view the creditor may be required to provide continuing disclosure to the debtor under section 18 as the situation does not fall within any of the exceptions listed under section 21. However, this approach is by no means free from doubt with resulting compliance and enforcement uncertainty.

Recommendation

150. We recommend that Parliament makes it clear whether continuing disclosure is or is not required in these circumstances.

Reasons

151. In our view providing continuing disclosure to consumers in these circumstances is consistent with the purposes of the Act (and particularly in accordance with section 3(b) (iii) as it allows debtors to monitor the performance of their consumer credit contracts).

152. However, we note that the Australian NCCP Act deals with this scenario explicitly. In their equivalent of section 21, the creditor does not have to provide continuing disclosure where:

> The debtor was in default under a continuing credit contract during the preceding 120 days, or during the statement period and the 2 immediately preceding statement periods, whichever is the shorter time, and the credit provider has,

[39] National Credit Code clause 145.

before the commencement of the statement period, exercised a right not to provide further credit under the contract and has not provided further credit during the period.

153. We suggest that Parliament take this opportunity to clarify the law in this area.

The Bill should clarify what happens if a creditor repossesses goods but does not offer them for sale

Issue

154. We are concerned that the provisions of the Bill will incentivise creditors to hold repossessed goods instead of offering them for sale.

Recommendation

155. We think that creditors should be prohibited from continuing to charge interest and fees if they fail to offer repossessed goods for sale as soon as practicable in accordance with the provisions of the Bill.

Reasons

156. We are aware of cases where the creditor has held repossessed goods for up to a year without offering them for sale while continuing to charge interest and fees on the loan. We are also aware of cases where the creditor has repossessed goods but has simply disposed of them instead of returning them to the debtor. Under the Bill there are no consequences for such conduct.

157. There are consequences for the creditor under the Bill once repossessed goods are sold[40] but no express consequences for failing to offer goods for sale as soon as practicable.[41] Accordingly we think that Parliament should ensure that if a creditor fails to offer goods for sale as soon as they are required to under the proposed section 83S, the goods are treated as having been sold under section 83ZG.

[40] The Bill provides at proposed section 83ZG that once goods are repossessed and sold, the creditor cannot continue to charge interest and fees on the debt; the debt is effectively frozen.

[41] Proposed Section 83S.

Failing to offer goods for sale – an example

In the context of an investigation, the Commission obtained copies of a creditor's file notes relating to repossession. The file notes included the following comments in relation to one debtor:

> this place was awful, debtors own next to nothing and what they did have wasn't worth much. Continued to repo the only seat in the house a 2 seater couch and … microwave.

and later:

> 2 seater brown couch and Toshiba microwave disposed of as not in working order and/or of nil value.

The creditor in this case continued to charge interest and fees on the loan after the repossession activity.

Lender Responsibility Code and Principles

The LRPs and the Code should come into force at the same time

158. While we are supportive of the LRPs and the development of the Code, we strongly submit that the Code and the LRPs should come into force at the same time. Any delay in the development of the Code will delay enforcement of the LRPs. If the Commission were to enforce the LRPs prior to the development of the Code:

    158.1 the Commission may unknowingly take an enforcement approach that is not reflected in the Code once it is developed; and

    158.2 there will be significant uncertainty in the industry while the Code is being developed about what a creditor is actually required to do.

159. The Commission supports the introduction of the LRPs. In our view there are currently gaps in consumer credit law that will be filled by the introduction of the proposed LRPs.

160. The Commission wishes to be involved in the development of the Code.

The LRPs should apply to all creditors within the industry

Recommendation

161. We believe that the LRPs should apply to all creditors within the industry. In our opinion, neither banks nor any other group of lenders should be excluded.

Reasons

162. If creditors are already complying with LRPs, they are unlikely to face significant compliance costs in meeting the Principles set out in the Bill.

163. The Commission does not support business exceptions but rather endorses principles of general application. It is consistent with a principles-based approach to legislation to require all creditors to comply with the same rules. If, for example, banks were to be excluded from LRPs, that would mean that some credit card issuers (American Express, GE) would be required to comply with LRPs, but other credit card issuers (banks) would not. This would set up arbitrary distinctions between credit providers.

164. We consider the LRPs will be of practical application to the banks. There is some suggestion that credit card defaults are a significant issue for consumers and banks. This suggests that there may be some breaches around LRPs in this area – particularly that banks may not be ensuring that debtors are in a position to meet repayments. We understand that this has been an issue in Australia and that ASIC has, since the introduction of the Australian NCCP Act, undertaken an industry review of several high level lending practices, including the way in which banks increase credit card limits. ASIC found that banks did little assessment of debtors' ability to repay the credit available from higher limits. Given the market participants in New Zealand and Australia are the same or similar we suspect that this may be the case here.

Ensuring that debtors are in a position to meet repayments?

We recently interviewed a debtor whose WINZ benefit was subject to an attachment order (a Court order deducting an amount from her wages to repay a debt) of $75.00 per week. When the debt was paid off her bank offered to extend her credit to $15,000.

165. We do not believe there is justification for excluding creditors subject to industry codes of practice, or other regulations (such as Reserve Bank regulation). The LRPs are designed to address concerns about conduct towards debtors, which those codes and regulations may not deal with.

166. Even if we could be completely satisfied that the banks are, in all respects, compliant with the LRPs, there is no guarantee that they will remain so in the future. Applying LRPs to all creditors will ensure they are all subject to the same obligations now and into the future. This should assist in the objective of increased compliance across the whole sector over time.

Financial Service Providers (Registration and Dispute Resolution) Act 2008

167. The Commission has three submissions that relate to the interaction between the CCCF Act and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).

    167.1 The definition of creditor should be the same in both to avoid the prospect of creditors under the Act avoiding FSP Act registration.

    167.2 The Commission should be a body that the registrar can share information with.

    167.3 Dispute resolution schemes should be required to report to the Commission if material complaints are received about creditors.

The definition of "creditor" in the FSP Act should be the same as the definition of "creditor" in the CCCF Act

168. All persons who provide credit under a credit contract are required to be registered. There appears to be a loophole which allows some creditors to avoid registration where they have had their loan books assigned to them.

169. For example we have had a creditor advise us that it does not have to be a part of a disputes resolution scheme because it did not initiate its loans; its loans were assigned to it. The creditor claims that as it did not originate the loan, it does not "provide credit under a credit contract" as required for registration. The creditor has claimed to have taken legal advice about this issue.

170. We would recommend that the Committee take this opportunity to address any inconsistencies in the application of the Acts to avoid any confusion by incorporating the CCCF Act definition of "creditor" in the FSP Act.

The Registrar should be able to share information with the Commerce Commission.

171. The Commission's ability to identify problems within the credit industry and contraventions of the Act depends to some extent on the quality of information it receives. The Commission has good intelligence systems in place; however, the more information we can obtain about the financial services industry, the better.

172. It would be beneficial for the Commission to be included as a body that the Registrar can share information with under section 34(4) of the FSP Act. Currently section 34 allows the Registrar to communicate with other specified persons or bodies where the Registrar considers that it may assist that person or body in the exercise of its powers, functions or duties. The Commission is not currently one of those specified persons or bodies.

173. There may well be circumstances where the Registrar has information about a financial service provider that is relevant to a Commission investigation. Currently the Commission would only be able to obtain that information by issuing a notice under section 98 of the Commerce Act, and then only if it knows that the Registrar

has information that may be relevant to the Commission. Issuing notices is relatively expensive and time consuming for both the Commission and the party receiving the notice.

174. Therefore it would seem much simpler to authorise the Registrar to communicate with the Commission, particularly where the statutory mechanism already exists.

Dispute Resolution Schemes should be required to report to the Commission if they receive a series of material complaints against a credit provider

175. Under section 64 Dispute Resolution Schemes are required to report to licencing authorities if they receive a series of material complaints about particular licenced providers. Currently the only licencing authorities are the Financial Markets Authority for financial advisors and the Reserve Bank of New Zealand for banks.

176. We consider that if there are material complaints about a particular creditor, the scheme should be required to report to the Commission, as the body charged with enforcing the Act. This will add to the Commission's ability to fulfil its functions under section 111 of the Act and will assist it in monitoring trade practices in credit markets.

177. Should you have any questions relating to these submissions please contact:

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Attachment A - Drafting Errors and technical issues

Drafting errors

178. Clause 16 - section 23 - refers to subsection (2) in paragraph 2. It should refer to subsection (3).

179. Clause 43 - section 83P - refers to schedule 3A. It should be 3B.

180. Clause 57 - section 102 - refers to "money due under the lease". It should refer to "money due under the buy-back transaction".

181. Schedule 3B(i). This part of the schedule seems to have been copied and pasted from Schedule 3A and does not make sense.

Technical Issues

182. Clause 6 - the new definition of "default". The word "default" is used throughout the Act in contexts where it is not intended to relate to a default that triggers a right of repossession. While the interpretation provisions say "unless the context otherwise requires" it seems unnecessary to have this argument. "Default" could have the meaning ascribed to it by clause 5 of the Bill for the purposes of Part 3A only.

183. Section 16 - Leases that are treated as consumer credit contracts under section 16 should be required to disclose the key information in a meaningful way. Section 16 leases are currently required to provide disclosure of key information in accordance with schedule 1 which requires disclosure of:

    183.1 the initial unpaid balance;

    183.2 annual interest rates;

    183.3 credit fees and charges; and

    183.4 how the reasonable estimate of creditor's loss on full prepayment will be calculated.

    However, consumer leases (that are required by section 16 to be treated as consumer credit contracts) do not generally have an "unpaid balance" and "annual interest rate and credit fees", and "full prepayment" is not applicable. There may be a cash price for the goods and there are likely to be periodic lease payments. The requirement to provide Schedule 1 disclosure is therefore generally not possible, and does not set out the information that the debtor requires about the lease. One of the most important pieces of information for a consumer is what they will have to pay if they cancel the lease, but this is not required by Schedule 1. We suggest that section 16 leases should be required to disclose information under Schedule 2 of the Act with the additional requirement that the disclosure includes a statement of a debtor's right to cancel the contract.

184. Proposed section 32 - We are concerned that the amendments to this section could be read to mean that the current model disclosure forms are mandatory when we understand that this was not the intention.

185. Proposed section 40 - We support the amendment to the default interest provisions restricting the creditor's ability to charge default interest to the amount in default and for the length of the default. We note however, that the Bill does not address the situation where a creditor is able to call up the entire unpaid balance on the debtors' default and then charge default interest on the entire unpaid balance. We suggest that the Act provide that "where the contract provides that the total advance falls due for payment immediately on the debtor's default, default interest is payable only on the part of the unpaid balance that was due notwithstanding that provision".

186. Clause 26 – proposed section 44A. We support the amendments as far as they go. However, there are still issues with the wording of the section.

186.1 It is not clear exactly what the Court is required to take into account when determining the reasonableness of a default fee. For example it is not clear whether the creditor's reasonable average costs that relate directly to the "type of default" are different from any costs relating directly to the "nature of the default".

186.2 Clause 26 is likely to affect the meaning of the word "costs" in section 42 and the new section 44 and create further confusion about what exactly creditors can recover in fees. Clause 26 refers at section 44A to "the creditor's reasonable average costs (including the creditor's reasonable administration costs and any financial loss suffered by the creditor)" which seems to suggest that the word "cost" includes the creditor's losses. We suggest that clause 26 (44A(c) Default Fees) reads:

> whether that amount exceeds a reasonable estimate of the creditor's reasonable administration costs and any financial loss suffered by the creditor relating to the type of default involved.

187. Existing section 48 - It is not clear whether this section applies to overpayments on consumer credit contracts, particularly whether it requires creditors to refund payment to debtors once the loan is repaid. Our problems in this area most often arise in relation to mobile shops. A debtor purchases an item on credit and authorises a direct debit. The shop continues to collect the instalments after the payment of the purchase price. The shops are reluctant to provide refunds for overpayments, and often charge substantial fees. (We have anecdotal information that the shops often have multiple copies of the direct debit forms and re-submit them to the bank if one is cancelled). In many cases, the debtor is encouraged to make a further purchase to "use up" their credit. It would be useful if section 48 could be amended so that it clearly requires a creditor to refund overpayments.

188. Clause 43 – proposed section 83J – states that a creditor must provide entry documents on entry and "at any subsequent time". This suggests that the debtor

can keep asking for documents during the repossession process and the creditor is required to provide them. This would seem to be (potentially) a fairly onerous obligation for creditors. We would suggest that there might reasonably be some limits on the creditor's duty to keep providing documents to the debtor.

189. Clause 43 – proposed section 83Q(2)(a) states "after the consumer goods have been taken". This should say "after the consumer goods have been repossessed".

190. Clause 43 - proposed section 83ZA - refers to "the register" without defining what that register is. Presumably it is the Personal Property Securities Register (PPSR). We suggest that if this is the case it should be made explicit.

191. Clause 43 - proposed section 83ZD - refers to a "financing statement" without making it clear that it is a "financing statement" under the PPSR. We suggest that if this is the case it should be made explicit.

192. Clause 45 - proposed section 87 appears to have removed the statutory jurisdiction for the Disputes Tribunal to consider hardship applications. This removes a significant protection for debtors. If they are required to file hardship applications in the District Court it will significantly increase their costs which is likely to be prohibitive for many debtors.

193. Proposed section 89(1)(a) and (b) relating to statutory damages for breaches of continuing disclosure and request disclosure. We believe the reference to "interest charges and credit fees" should be "interest charges, credit fees and default fees".

194. Clause 49 - proposed section 93 now seems to allow a Court to grant orders under section 93 if a creditor fails to comply with the Responsible Lending Code even though compliance with the code is not mandatory. The reference to the code needs to be removed from this section.

195. Clause 50 - proposed section 94(aa)(i)(B) should refer to a "consumer credit contract" not a "consumer contract".

196. Clause 54 - proposed section 99 should be amended to make it clear that fees that accrued during the period of non-disclosure cannot be charged after disclosure is made.

197. Clause 55 - proposed section 99B(1B) should say "payable to a third party".

198. Clause 56 - proposed section 101 – "costs of the lease" has not been defined.

199. Clause 57 - proposed section 102 – "costs of the buy-back transaction" is not defined.

200. Clause 60 - proposed section 108 - We are not clear about what is likely to be "minor misconduct" in this section. In particular what would be minor misconduct that resulted in a buy-back transaction being reopened? We are also not clear what is

meant by a conviction under the Act “involving dishonesty” given that most of the Act offence provisions are strict liability.

201. Proposed Schedule 3A - there should be a requirement that the creditor set out the “period for remedying the default”.

202. Proposed Schedule 3B - the key information does not include information about:

202.1 the debtor’s right to require a sale;

202.2 the debtor’s right to obtain a valuation;

202.3 the debtor’s right to force a sale if the goods have not been sold within 6 weeks.

Attachment B – Background documents to the 2003 Credit Law Reform

203. It is useful to canvas the policy intention set out in the background documents to the Credit Law reform in some detail. The legislative history confirms that the 2003 Credit Law reforms were largely driven by the perception that the Credit Contracts Act 1981 and the Hire Purchase Act 1981 had become outdated and no longer provided adequate protection for consumers. In addition, there was a perceived need for differentiated treatment of business and consumer lending, so that appropriate targeted consumer protection measures could be imposed. Within the broad category of "consumers" there was a particular focus on protecting unsophisticated borrowers.

204. In introducing the Consumer Credit Bill for its first reading, the Minister of Consumer Affairs said:

> The purposes of the Bill are to protect interests of consumers in respect of credit contract and lease contracts, to enable consumers to become informed at the time of entering a contract and throughout its duration and to provide transparent rules for charging interest and fees and calculating balances.[42]

205. The initial public consultation documents in the Consumer Credit Law Review explained the importance from the consumers' perspective of comparability between credit products:[43]

> If the law provides no reasonable basis for comparison, information asymmetry between borrowers and lenders may reach a level where effective competition, and hence efficient outcomes, are compromised.

206. The third consultation document dealt specifically with transparency in consumer credit. In discussing the charging of general non-interest charges and fees, within its critique of disclosure requirements under the Credit Contracts Act 1981 the Ministry stated:[44]

> These types of fees are lump-sum charges that do not necessarily relate to a specific expense incurred by a lender in setting up a loan. Since these charges affect the cost of the loan to the consumer they should be included in the annual finance rate.

207. In considering options for reform, one option considered was to prevent lenders from charging fees altogether. However, this option was rejected, apparently because of concern that it would stifle innovation in the development of credit products. Specifically the Ministry considered that:

> Most importantly restrictions on fees would limit product development and inhibit the ability of lenders to develop differentiated products. This is because lenders could no longer match specific costs to specific services for meeting borrowers' needs.

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42 (18 February 2003) 606 NZPD 3511.

43 Ministry of Consumer Affairs *Consumer Credit Law Review Part 1: Setting the Scene* (June 1999) part 5.2.

44 Ministry of Consumer Affairs *Consumer Credit Law Review Part 3: transparency in Consumer Credit: Interest, Fees and Disclosure* (April 2000) at part 6.1.1.

208. Flexibility was considered important to give lenders scope to increase their competitive advantage in the marketplace by lowering costs or increasing services, which should be reflected in the level of fees charged by lenders. The Ministry considered that allowing fees to be charged could promote transparency if those fees reflected specific costs matched to specific services.

209. The Ministry went on to consider options for regulating fees. One option included allowing the Courts to review fees against certain criteria. The Australian Consumer Credit Code (Australian Code) which allowed the Court to review establishment fees, early repayment fees and termination fees to decide if they are "unconscionable" was taken as the example. One effect of this approach highlighted by the Ministry was that it would restrict the type of fees that could be charged so that, for example, "an establishment fee must relate to the cost of approving and setting up a loan".

210. The approach from the Australian Code was eventually favoured in part because it allowed greater room for product innovation than a total prohibition on fees. However, this was balanced by a concern that because there was no standardisation or definition of fees and charges in the Australian Code, it was difficult for consumers to work of the effect of a particular fee when making a decision on entering into a credit contract.[45] It was because of this concern that the Act has been more prescriptive about fees than the Australian Code was, which includes writing into the Act the definitions of the various fees.

211. The eventual recommendation following the review, from the Acting Minister of Consumer Affairs to the chair of the Cabinet Finance, Infrastructure and Environment Committee, recommended replacing the Credit Contracts Act 1981 and Hire Purchase Act 1971 with a Consumer Credit Bill (the CC Bill).

212. In relation to how non-interest charges and fees should be dealt with under the CCC Bill the Acting Minister recommended adopting the approach taken in the Australian Code. Again, the focus was on increasing fairness and transparency for borrowers. Specifically the Minister recommended:[46]

> In respect of charges other than interest, lenders should be free to charge any credit fee, provided it is not unconscionable and that it is disclosed. It should be provided that establishment fees are unconscionable if they exceed a lender's reasonable costs in setting up and documenting a loan. Without this restriction, a lender may load its return into the establishment fee as a way of defeating the prohibition on charging interest in advance.

213. The accompanying technical recommendations included:[47]

> In determining whether an establishment fee in unconscionable, the Court must have regard to whether the fee or charge is equal to the lender's reasonable costs of determining an application for credit and in the initial administrative costs of

[45] See the Third Consultation Document at 9.2.4.
[46] FIN (01) 91: Minister's recommendations at [39].
[47] Ibid appendix at [10.2].

> documenting the credit contract and providing the credit, or is equal to the credit provider's average reasonable costs of those things.

214. As already noted, although throughout the consultation process the Australian Code was taken as the model for the relevant sections of the Act, during the drafting process there were a number of departures written into the Bill to reflect the New Zealand position. Of particular note is the replacement of the term "unconscionable" from the Australian Code, with "unreasonable" in respect of the limit on fees. This appears to have been a deliberate decision by Parliament to depart from the Australian position and strengthen the restrictions around fees. It also signals and intention to deliberately avoid the distinct oppression threshold associated with s 9 of the Credit Contracts Act 1981 (which defined "oppressive" to include "unconscionable").

215. The initial briefing paper to the Commerce Select Committee carries through the key point that establishment fees may be "unreasonable" if they exceed the actual cost of establishing the credit contract. For example, the report states:[48]

> Clause 37 provides that establishment fees may be unreasonable if they exceed the actual cost of setting-up (establishing) the credit contract. This will prevent two undesirable practices:
>
> Loading an amount of interest into the establishment fee;
>
> Purporting to offer a discount on the cash price for goods sold under the credit sale, while increasing the establishment fee.

216. The need for substantive restrictions on fees was rationalised in the following terms:[49]

    216.1 It is necessary to place substantive restriction on fees because otherwise creditors may be tempted to avoid the restrictions on charging interest in subpart 5 by imposing fees which are in the nature of interest charges. This practice would be facilitated by the narrow definition of interest in clause 5.

217. The debates on the Bill in the House of Representatives also indicated Parliament's intent to increase transparency and to provide information to lenders so they will know what they are required to pay and why. For example, on behalf of the Opposition, in the context of a decision of the treatment of brokerage fees, the Hon Tony Ryall summed up the purpose of the Bill as follows:[50]

> The purpose of the Bill is to declare to the borrower where the money is going.

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[48] Ministry of Consumer Affairs Consumer Credit Bill: Initial Briefing to the Commerce Select Committee (1 May 2003) p7.

[49] Ibid.

[50] (16 September 2003) 611 NZPD 8706.

Judicial comment on the policy intention underpinning the fee provisions

218. In Commerce Commission v Avanti Asher J stated:[51]

> Section 3 of the CCCF Act sets out its purposes. The first purpose is to protect the interests of consumers in connection with credit contracts…. the Commerce Commission rightly emphasised the consumer protection purpose of the CCCF Act, and it must be taken into account when the specific sections are interpreted.

219. Priestley J in *Commerce Commission* v *Bluestone Mortgages* accepted the CCCFA's clearly identified purpose of enabling consumer to make an "apples for apples comparison" between competing offers for credit.[52]

220. The Court of Appeal in *King* v *Norfolk Nominees* emphasised that "informed credit choices are one of the principal purposes of the statute".[53]

221. Hammond J in *Bartle* v *GE Custodians* described the role of the CCCF Act as part of a:[54]

> …strong imperative towards "truth in lending" which has been a feature of commercial law in this jurisdiction as with other jurisdictions, in more modern times. "Truth in lending" is not merely restricted to such obvious features as interest rates, but extends to what the transaction in its fundamentals is really all about.

222. The Court in *Sportzone & MTF* has recently held that the policy intention behind the Act is: [55]

- consumer protection;
- the provision of adequate information;
- identifying the circumstances in which fees can be charged, and the levels of them; and
- assisting the enforcement of lender obligations.

Enforceability is an important consideration

223. We note that the Court in *Sportzone & MTF* also recognised the importance of interpreting the fee provisions in a way that facilitated enforcement. Toogood J stated: [56]

> *If the statutory obligations of lenders are to have any meaning and a beneficial impact on lending behavior they must be capable of being readily understood and applied. Transparency and ease of expression will assist enforcement.*

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[51] *Commerce Commission* v *Avanti Finance Limited* (2009) 9 NZNBLC.
[52] *Commerce Commission* v *Bluestone Mortgages (NZ) Ltd* at n4 above.
[53] *King* v *Norfolk Nominees Ltd* [2012] NZCA 190.
[54] *Bartle* v *GE Custodians Limited* [2010] NZCA 174.
[55] Above n3 at [63].
[56] Above n3 at [62].