THE BIG PICTURE: CCCFA REFORM

A new consumer credit landscape

November 2021

BELL GULLY

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Introduction

Major changes to the Credit Contracts and Consumer Finance Act 2003 (CCCFA) will come into force from 1 December 2021. These changes will transform the regulation of consumer credit in New Zealand, substantially increasing the risks and compliance burden for retail lenders.

The changes have generated impassioned debate. They were driven by concerns that previous changes to the CCCFA, in 2015, did not go far enough to restrict predatory "loan shark" behaviour. However, the 2021 changes go much further than correcting that sort of behaviour – they will impact the entire credit sector. One consequence is that, from December, applicants for loans are likely to experience materially longer and more complex application processes when seeking access to credit. That will be the case with all applications for consumer credit, including home loans, personal loans, credit cards and loans to finance vehicle purchases.

In Australia (which originally inspired the introduction of "responsible lending" rules in New Zealand) the government is now seeking to ease restrictions on lenders, warning against "unnecessary barriers to the flow of credit to households." If the Australian government successfully pares back the regime (as proposed), it will leave a stark contrast to the detailed and prescriptive demands of New Zealand's new framework.

In this report, we look at some of the key consumer credit changes taking effect, the recent and anticipated enforcement trends, and the potential impacts for lenders and borrowers.

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Consumer credit: overview of the new landscape

KEY CHANGES TAKING EFFECT ON 1 DECEMBER 2021

Every director and senior manager of a lender under a consumer credit contract will need to exercise due diligence to ensure their organisation complies with the CCCFA. This includes: implementing (and requiring staff to comply with) procedures to ensure compliance with the CCCFA; ensuring that appropriate systems are in place to identify deficiencies with these procedures; and promptly remedying any deficiencies identified. There are significant pecuniary penalties in place if directors or senior managers breach this duty (of up to NZ$200,000 per breach, or joint and several liability for damages awards against the lender).

There are detailed new regulations setting out how a lender tests whether a loan is suitable for a borrower, and tests whether the borrower can afford the repayments. In addition, advertising of consumer credit products will need to comply with new advertising standards set by regulations.

There are new record-keeping requirements which require lenders to record how they were satisfied each borrower met the affordability and suitability requirements, and how they have calculated the credit fees and default fees they charge.

There will be a new certification regime under which all lenders under a consumer credit contract and all “mobile traders” will be required to be certified by the Commerce Commission (subject to certain exemptions, for example for banks or licensed insurers). As part of this process, the Commission must be satisfied that all the applicant’s current and prospective directors and senior managers are fit and proper persons to hold their respective positions. This requirement took effect from 1 October 2021.

OTHER CHANGES

In addition to the key changes summarised above, there are numerous other new requirements. These include:

- A requirement to provide an annual return to the Commerce Commission which will contain certain statistical information in relation to the lender’s business and its loan book.
- New requirements to provide disclosure of a lender’s dispute resolution scheme whenever they receive a hardship application or receive a complaint from a debtor, as well as information about financial mentoring services.
- A new "debt collection disclosure" requirement arising whenever a lender or debt collector takes a debt collection step.
- New prescribed disclosure requirements arising when a borrower agrees a variation to a loan.

Due Diligence

From 1 December 2021, every director and senior manager of a lender will have to comply with a new duty to exercise "due diligence" to ensure that the lender complies with its duties and obligations under the CCCFA.

This has been one of the most attention-grabbing changes under the amended regime.

What does "due diligence" require?

Due diligence is defined non-exhaustively. It includes taking reasonable steps to ensure that the lender:

- requires its employees and agents to follow procedures, or has implemented automated procedures, that are designed to ensure compliance with the Act and regulations,
- has in place methods for systematically identifying deficiencies in the effectiveness of the procedures for compliance, and
- promptly remedies any deficiencies discovered.

What guidance is available?

The Commerce Commission has issued a guidance document on the new due diligence duties for directors and senior managers. This is likely to provide a helpful resource for lenders' directors and senior managers, although it is relatively light on specifics, and much is left to directors and senior managers in terms of deciding how to satisfy themselves that they have exercised the care, skill and diligence of a reasonable director/senior manager.

Helpfully, the guidance recognises that directors and senior managers play quite different roles, noting: *"In general, directors are more likely to satisfy their due diligence by directing and requiring management to undertake key tasks focussed on fulfilling legislative and regulatory obligations, setting the approach to resource allocation and prioritisation, and driving a culture of compliance. In many organisations, senior managers will be expected to be more involved in the implementation and performance of compliance measures in areas in which they have responsibility or influence."*

The guidance emphasises the need to understand and pay attention to CCCFA related matters, and notes that while directors and senior managers may rely on experts, they should have enough knowledge about the nature of the credit being provided, and the CCCFA obligations, to ask "the right questions" and "challenge" information provided to them.

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Due Diligence (continued)

Who is caught?

Anyone with a governance role comparable with that of a director is classed as a "director" for the purposes of the due diligence duty.

As for "senior managers," that captures any person who exercises "significant influence" over the management or administration of the lender. Whether a person is a "senior manager" in this sense involves an assessment of their level of authority and influence over the lender. The Commission has advised that a person could potentially be caught even if they have no direct responsibility for credit functions and decisions. Generally, where a lender has designated certain individuals as "senior managers" for the purposes of registration under the Financial Services Providers Register (as required under the Financial Service Providers (Registration) Regulations 2020), those same individuals will constitute senior managers for the purposes of the CCCFA.

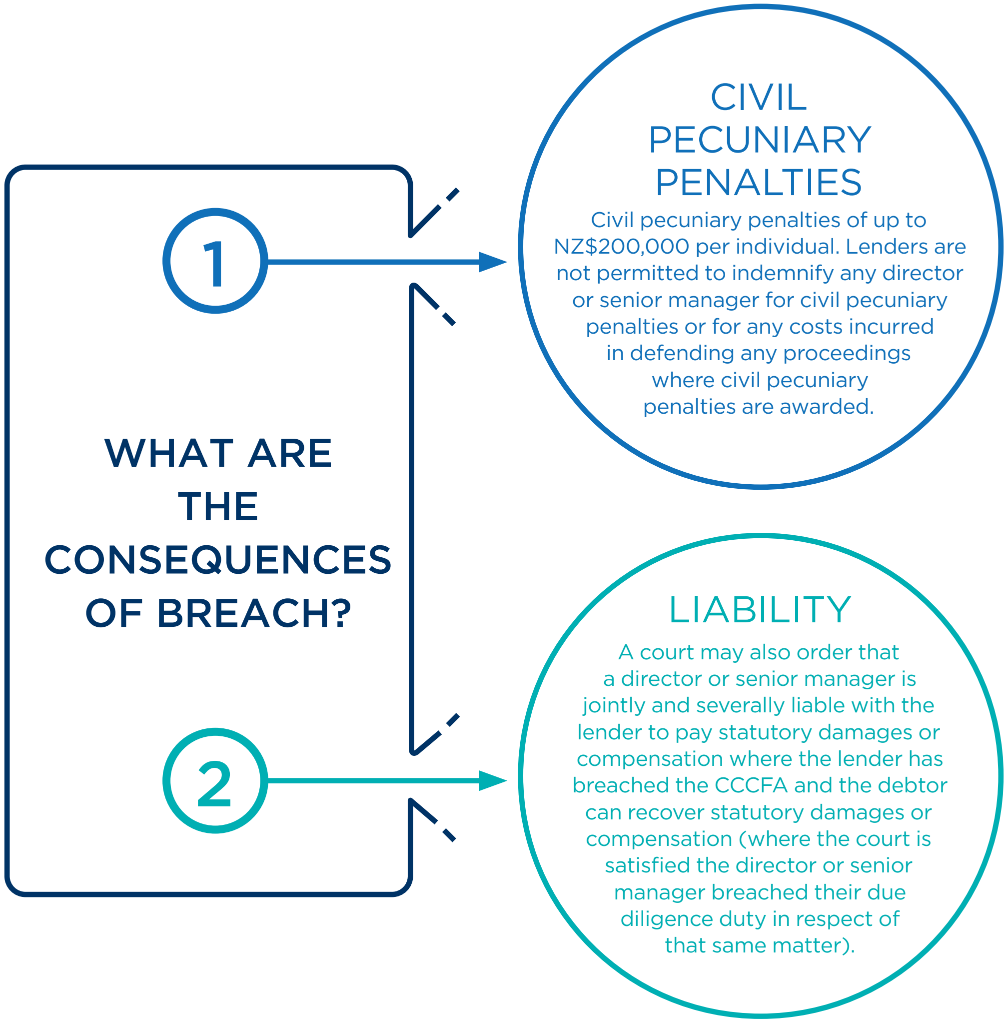
What standard will apply?

The test is objective, and also relative. Each individual subject to the duty must exercise the care, diligence, and skill that a reasonable director or senior manager (as the case may be) would exercise in the same circumstances, but taking into account:

- the nature of the business, for example its size and the nature of credit provided, and
- the position of the director or senior manager and the nature of the responsibilities undertaken by the director or senior manager.

The Commission's guidance notes: "The greater your level of influence in areas of the business that are impacted by obligations imposed by the CCCF Act, the greater the level of care, diligence, and skill likely to be expected of you in performance of your due diligence duty."

Directors and senior managers will not necessarily breach the due diligence duty just because the lender breaches the CCCFA. The Act acknowledges that breaches may occur, but directors and senior managers may nevertheless have exercised their due diligence duty if they have overseen the development of sufficient procedures to ensure compliance, taken reasonable steps to implement those procedures, monitored compliance effectively, and moved quickly to fix errors when they have arisen.



Responsible Lending

The government first introduced responsible lending obligations in 2015 with the objective of ensuring that loans issued to consumer borrowers were suitable and affordable for those borrowers. The obligations included new requirements on lenders to make "reasonable inquiries" of borrowers before issuing loans, and to assist borrowers to make "informed decisions". The regime was intended to be flexible and "principles based" and allowed a broad range of approaches to the various requirements. However, the principles were so broad it made it difficult for lenders to know precisely what was required. Equally, it proved difficult for the Commerce Commission to identify specific breaches, and the principles were very rarely enforced.

In reaction to the uncertainty and to bolster the responsible lending regime, the government has introduced new regulations with much more prescriptive requirements around: (a) the suitability and affordability tests which lenders must conduct before issuing a loan to a borrower; and (b) advertising of consumer credit contracts.

Credit assessments

The suitability regulations are designed to set out a list of specific inquiries, including in respect of a borrower's purpose in seeking credit, the required term of the loan, and the amount (as well as other more intricate matters such as whether they accept the cost of any "non-avoidable" fees for add-ons that were not part of their stated purposes). The affordability regulations require various inquiries to identify whether the borrower can make repayments without suffering substantial hardship. In general terms: if the borrower will rely on income to make repayments (for certain high-cost loans) the lender needs to create an estimate of the borrower's income and then also expense estimates using various specified tests, including new requirements to verify information received. Where the lender knows that the borrower will rely on means other than income to make repayments (or where other exceptions apply which indicate the risk to the borrower is low) a more flexible standard applies.

The regulations governing responsible lending are complex and include a number of untested standards which are capable of wide-ranging interpretation.

To supplement the new requirements, MBIE has issued an updated version of the Responsible Lending Code. This attempts to assist lenders in navigating the new regulations. However, the flowchart provided in the Code, though intended to simplify things, highlights the remarkable complexity of the new regime and the numerous gateways and decision points that lenders must navigate.

Responsible Lending (continued)

AMONG THE UNCERTAINTIES:

When calculating loan affordability, lenders must ensure that there is a "reasonable surplus" after deducting a borrower's expenses from their income, or that the calculation includes "reasonable buffers." There is no guidance within the regulations (or the CCCFA, or the Code) as to the specific extent of surplus or buffer required. Lenders are left to guess what proportion will be appropriate in each case.

Under a particular exemption, a lender can make less detailed inquiries of a borrower where it is "obvious in the circumstances" that the borrower can make repayments without suffering substantial hardship. It remains unclear in what circumstances a borrower can be said to "obviously" afford a loan. The updated Code offers one specific example (a borrower with assets of NZ$1 million and income of NZ$350,000, seeking a credit card with a NZ$10,000 credit limit) but is unclear whether that is intended to represent the threshold. This means that many lenders will be wary of relying on the exemption until it is clarified by case law or updated regulatory guidance.

Lenders need to make various mandatory adjustments to a borrower's expenses for the purposes of the affordability calculation. However they only arise in certain circumstances where there is "a significant risk that the initial estimate materially underestimates relevant expenses". There is no clarity around how significant the risk needs to be, or how material the underestimation.

The required expense adjustments include comparing borrower-declared expenses to reasonable "benchmarks" which must be based on "a robust statistical methodology". The regulations give one example (Statistics New Zealand's Household Economic Survey) but do not otherwise clarify when a methodology will be "robust".

These examples, together with many other similar uncertainties, will require lenders to make difficult judgement calls in seeking to steer a compliant pathway through the regulations.

Responsible Lending (continued)

Mortgage decline rates set to skyrocket as responsible lending changes bite

05:00, Nov 16 2021

Lenders will need to dig deeper before approving **loans** from December 1

Economist reveals impact of challenging market on mortgage and property activity

"90% of what we could do two months ago, we can no longer get approved"

Why your financial habits are about to matter more than ever

05:00, Oct 08 2021

Material changes

One other feature of the responsible lending changes is that the new assessment requirements apply upon any "material change" to a loan (not just at the outset of a loan, as previously). A "material change" is defined as essentially a new advance or an extension of a credit limit. This will mean that lenders who extend credit to existing borrowers on existing facilities will need to take care to ensure that they run all affordability and suitability assessments in the same way as for a new loan.

Advertising regulations

The new regulations also cover the advertising of consumer credit contracts. Requirements include:

- If the advertisement states a payment amount, it must also display the total amount of payments if that can be ascertained, or the annual interest rate or rates for the advertised products and (for credit sales) information about lump sum payments.
- If the advertisement includes an interest rate, it must state the annual interest rate or range of rates that may apply as well as any mandatory credit fees. It must also state if an annual interest rate is fixed for the term, or any part of the term or if the interest rate is not fixed for that term.
- It must also state if an annual interest rate is fixed for the term, or any part of the term or if the interest rate is not fixed for that term.
- If a lender advertises interest free credit contracts, the advertisement must include any mandatory credit fees.

There are also prohibitions on specific advertising practices. For example, it is not permissible to say that the lender will not take into account the borrower's characteristics or credit history, or that the loan assessment will be done within a certain number of minutes or hours (without making clear that responsible lending-related assessments will need to be completed first).

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Penalties for breach

There are new pecuniary penalties of up to NZ$600,000 (and NZ$200,000 for an individual) for certain breaches of the CCCFA, including breaches of the lender responsibility principles, breach of directors' and senior managers' due diligence duty, failure to comply with record-keeping requirements, unreasonable credit or default fees, breaches of new high-cost lending requirements, and any failure to be certified.

In addition, the following enforcement consequences can also apply:

- Statutory damages (typically capped at the lesser of NZ$6,000 or 5% of the total advances under the loan), compensatory damages, and exemplary damages (not available where a criminal fine has been imposed).
- The courts can make orders to allow for "affordable repayment" of outstanding debt for breach of the lender responsibility principles.
- The Commission can now accept enforceable undertakings (mirroring equivalent powers under the Commerce Act 1986).
- Court-ordered injunctions preventing contraventions.
- For disclosure breaches, possible impacts to enforceability of the contracts, including fees and interest.
- A criminal fine of up to NZ$600,000 for a body corporate (see s103(1)(b)).

Where multiple breaches are "of the same or a substantially similar nature and occurred at or about the same time" the total criminal fine is limited to the maximum for a single offence (see s104).

Enforcement Trends

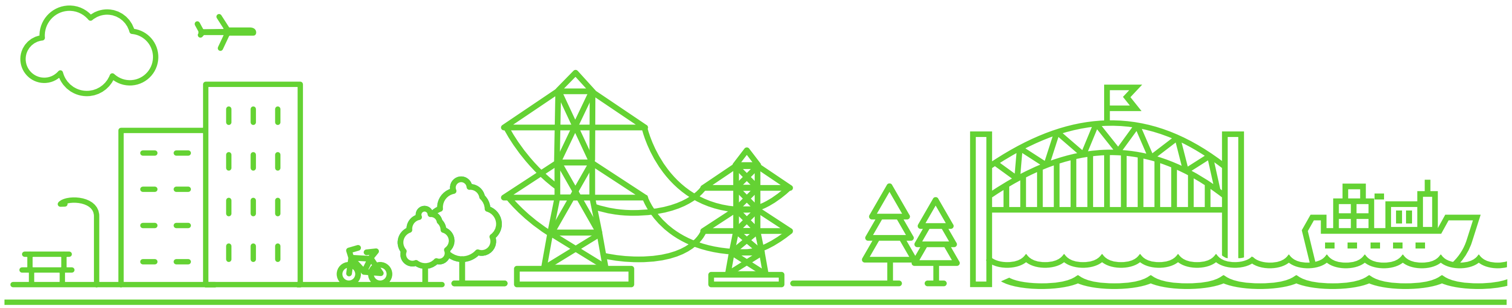
The Commerce Commission has enforced the CCCFA since its inception in 2005. Over the past decade, there have been a series of broadly observable trends.

Early on, the Commission's enforcement steps mostly focussed on disclosure obligations or the requirement to charge reasonable fees. Often this was targeted at small lenders.

The Commission also brought a test case against Sportzone Motorcycles and others in 2009, to clarify what costs could be recovered through credit fees (resulting in a finding by the Supreme Court in 2016 that fees should be closely connected to transaction-specific costs).

More recently, the Commission's enforcement approach has been characterised by a broader range of proceedings including: (a) a growing number of significant settlements with larger lenders; (b) a more recent focus on responsible lending by high cost lenders such as Ferratum, Moola and Pretty Penny.

It will be interesting to see what approach the Commission takes to its new powers after December, including its approach to enforcement of the new due diligence duty and the prescriptive responsible lending obligations.



Commerce Commission enforcement of CCCFA: timeline

The Commerce Commission's focus has historically been on third-tier lenders, for alleged disclosure breaches or unreasonable fees

2010 - 2012

- Dolbak Finance Limited fined NZ$2,000 for disclosure breaches.
- Takurunga Management fined NZ$30,500 for unreasonable fee.
- eFeMCee Finance fined NZ$55,475 for unreasonable fees.
- Barry Hunt fined NZ$18,532 for initial disclosure breaches.

2013 - 2015

- Tiny Terms fined NZ$77,200 for initial disclosure breaches.
- Sunway Finance Limited/ Yuan Yang fined NZ$30,000 for initial disclosure breaches.

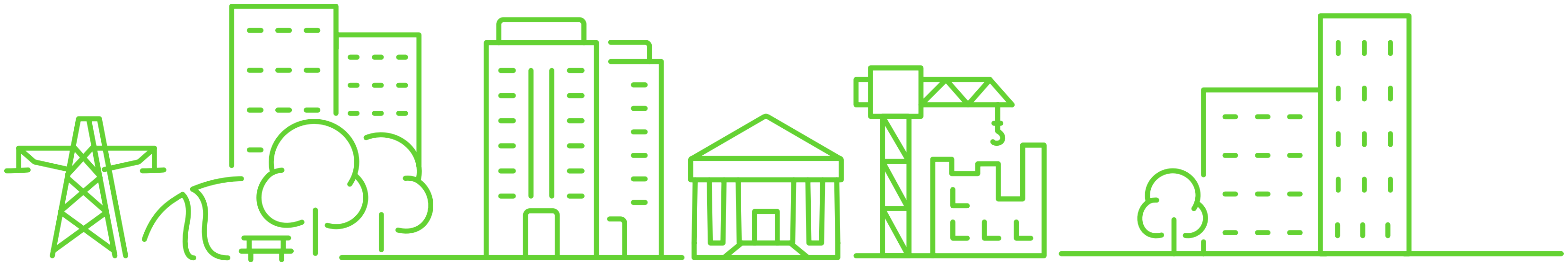
2016

- Twenty Fifty Club Limited and Gavin Marsich fined NZ$38,000 for initial disclosure breaches and unreasonable fees.
- Betterlife Corporation and Goodring Company Limited fined NZ$73,500 for initial disclosure breaches.
- Ace Marketing fined NZ$15,000 for initial disclosure breaches and unreasonable fees.
- Smart Shop Limited fined NZ$135,000 for initial disclosure breaches.
- Acute Finance fined NZ$22,000 for unreasonable fees.

2017

- Bestdeals 4 You Limited fined NZ$47,250 for initial disclosure breaches.
- Cash to You Loans Limited fined NZ$28,000 for initial disclosure breaches and unreasonable repayment fees.
- Budget Warehouse fined NZ$100,000 for initial disclosure breaches.
- Zee Shop fined NZ$108,000 for initial disclosure breaches.
- Macful International fined NZ$126,000 for initial disclosure breaches.

Enforcement Trends (continued)



2018 - 2020

Responsible lending enforcement and settlements with larger lenders

2018

- Rapid Loans warned about failure to make reasonable inquiries.
- Proceedings filed against Ferratum for failure to make reasonable enquiries.
- Commission publishes settlement with Westpac relating to variation disclosure (Westpac agreed to refund affected borrowers).
- Aotea Finance fined NZ$48,750 for taking security over prohibited essential household items.

2019

- Alternate Finance and Crester Credit Company fined NZ$103,500 and NZ$21,000 for taking security over prohibited consumer goods.
- Linsa Finance agree to pay NZ$350,000 for initial disclosure breaches.
- Aotea Finance agree to pay NZ$2.8 million in refunds for disclosure breaches.
- Ezi Finance agree to pay over NZ$400,000 for disclosure breaches.
- Commission files proceedings against Real Finance alleging unreasonable fees.
- Commission issues proceeding against Pretty Penny alleging responsible lending breaches.

2020

- Westpac agrees to pay NZ$3.7 million for initial disclosure breaches.
- ANZ agrees to pay NZ$29.4 million for responsible lending breaches related to loan letters.
- HSBC warned over variation disclosure failures re interest rate increases.
- Profile Finance agrees to pay borrowers NZ$945,334 for failing to provide disclosure information.
- Ferratum agrees to compensate 46 borrowers NZ$88,173 for responsible lending breaches.
- Pretty Penny undertakes to write off all outstanding loan balances for alleged responsible lending breaches.

2021

- ASB agrees to pay NZ$8 million compensation to borrowers for variation disclosure issues.
- Commission warns Auckland Council for responsible lending failures in relation to its Retrofit Your Home Program.
- UDC Finance agrees to refund borrowers for dishonour fees and late payment fees.
- Moola agrees to pay NZ$2.8 million to borrowers for unreasonable fees.
- ASB provides enforceable undertakings and refunds in relation to early repayment adjustment fees.
- Mainland Finance agrees to pay NZ$1.1 million to borrowers for unreasonable fees.
- Harmoney agrees to pay borrowers NZ$7 million for unreasonable fees.
- Moola agrees to compensate borrowers for responsible lending breaches.

2022

- Due diligence?
- Responsible lending regulations?
- Fee calculations?
- Record Keeping?

> “The consequences of getting it wrong could be significant... It is important that all lenders and mobile traders understand the changes to their obligations, for their own benefit, as well as for the benefit of the New Zealand consumers they are providing credit to.”

Anna Rawlings
NZCC CHAIR

Bell Gully's CCCFA team

If you have any questions about this report, please contact one of the team listed below or your usual Bell Gully adviser.

Sophie East
PARTNER

DDI +64 9 916 8668 MOB +64 21 899 619
sophie.east@bellgully.com

Jenny Stevens
PARTNER

DDI +64 4 915 6849 MOB +64 21 190 2973
jenny.stevens@bellgully.com

Murray King
PARTNER

DDI +64 9 916 8971 MOB +64 21 684 573
murray.king@bellgully.com

Jennifer Gunser
PARTNER

DDI +64 9 916 8757 MOB +64 21 704 923
jennifer.gunser@bellgully.com

Tim Fitzgerald
PARTNER

DDI +64 9 916 8882 MOB +64 21 770 472
tim.fitzgerald@bellgully.com

Richard Massey
SENIOR ASSOCIATE

DDI +64 9 916 8824 MOB +64 21 208 2355
richard.massey@bellgully.com

Sarah Leslie
SENIOR ASSOCIATE

DDI +64 4 915 6804 MOB +64 27 839 3146
sarah.leslie@bellgully.com

Alix Boberg
SENIOR ASSOCIATE

DDI +64 9 916 8356
alix.boberg@bellgully.com

BELL GULLY

AUCKLAND

VERO CENTRE
48 SHORTLAND STREET
NEW ZEALAND

WELLINGTON

ANZ CENTRE
171 FEATHERSTON STREET
NEW ZEALAND