MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Discussion paper

Review of consumer credit regulation

June 2018

newzealand.govt.nz

How to have your say

This discussion paper summarises MBIE's findings from the review of the Credit Contacts and Consumer Finance Act (CCCFA). We'd like your feedback on the issues, and on ways to address them.

Submissions process

Submissions on the issues and options in this document are due by 5pm on **23 July 2018**.

Please use the submission template provided at: ***http://www.mbie.govt.nz/info-services/consumer-protection/review-section-99-1a-credit-contracts-and-consumer-finance-act-2003***. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission. Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission by:

- sending your submission as a Microsoft Word document to ***consumer@mbie.govt.nz***.
- mailing your submission to:

  Competition & Consumer Policy
  Building, Resources and Markets
  Ministry of Business, Innovation & Employment
  PO Box 1473, Wellington 6140, New Zealand

Use and release of information

The information provided in submissions will be used to inform MBIE's policy development process.

MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission. If your submission contains any information that is confidential, you can clearly mark this within the text and provide a separate version excluding the relevant information for publication on our website.

Submissions remain subject to request under the Official Information Act 1982. Please provide reasons for withholding any confidential information that we can take into account if we receive any requests.

The Privacy Act 1993 applies to submissions. Please clearly indicate in the cover letter or e-mail accompanying your submission if you do not wish your name, or any other personal information, to be included in any summary of submissions that MBIE may publish.

Minister's Foreword

Most New Zealanders borrow money at some point in their lives. Often people will borrow money to meet their immediate needs and wants, or to finance important assets for their long-term future (such as housing, or vehicles to attend work or education).

Accessing credit can help New Zealanders achieve a long-term standard of living and meet the goals of individuals and families if done in a safe and affordable way.

However for some, borrowing money has the opposite effect. Practices such as excessive interest rates, high fees and penalties are trapping many in a debt spiral that has long term detrimental impacts on their financial situation and wellbeing.

Worse, it tends to be vulnerable members of our society who are most affected and can often find themselves in even deeper hardship as a result.

The 2015 amendments to the Credit Contracts and Consumer Finance Act 2003 were intended to prevent harm to consumers, by requiring responsible lending, including affordability and suitability assessments before loans are approved.

Yet I have consistently heard concerns that the changes have not worked as intended for some parts of our community.

I have seen evidence that some creditors are offering loans knowing repayments are unaffordable, meaning borrowers become trapped with unpaid debt. This results in debt that is many times the original amount borrowed due to high interest rates and penalty charges.

It is widely accepted that the problems around irresponsible lending are not simple. We must also acknowledge that many are struggling financially and therefore turn to credit as a short-term remedy to their situation.

As a Government we are committed to tackling many of the issues that contribute to financial stress by lifting financial capability and building a strong and inclusive economy.

In addition to this wider work, regulation can and should play a part in reducing consumer credit-related harm. That is why I asked for a review to assess the impact of the 2015 changes and identify what further steps may be needed to ensure responsible lending rules are effective for everyone.

While the new requirements under the 2015 amendments have led to better disclosure, lending and borrowing for many consumers, stakeholders have said that irresponsible lending – and consequent harm – has continued to be a serious problem, particularly for borrowers who are already in hardship.

This discussion paper seeks to confirm the nature and scale of the problems, and asks for feedback on potential regulatory options to address them.

I look forward to hearing from lenders and borrowers alike on the proposals in this paper. Your responses will help find the best ways forward.

Ngā mihi nui

Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

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Introduction and context

1. Using credit is a normal part of everyday life for many New Zealanders. According to the 2016 National Consumer Survey, over a quarter of all New Zealand consumers (29%) entered into a credit contract in the two years prior.

2. Consumer credit contracts are financial products that allow individuals to borrow money. They include housing loans like mortgages, but also other consumer finance like credit cards, personal loans, vehicle loans and credit sales[1].

3. Consumer credit contracts are regulated by the Credit Contracts and Consumer Finance Act 2003 (CCCFA), which aims to protect the interests of borrowers and promote fair, efficient and transparent markets for credit. The CCCFA's aims reflect that the consumer credit market, like other financial markets, has features that challenge its proper functioning in the interests of consumers. These include lenders generally being more sophisticated and informed than borrowers, and borrowers having limited access to information and various behavioural biases that reduce their ability to make good borrowing decisions.

4. At any time, a proportion of the population is at significantly higher risk of making poor consumer decisions. General risk factors include poverty, lower proficiency in English, disability, and low literacy and numeracy. These are heightened by financial shocks (like unexpected expenses or loss of income), stress or addiction. A greater proportion of Māori and Pacific people are exposed to some these risk factors (like poverty), and these groups are disproportionately impacted by poor conduct by lenders and problematic debt.

5. The overall number of vulnerable consumers of credit products in New Zealand can be estimated by looking at who is in hardship, and who has low proficiency in English. In New Zealand, about 12% of households report not having enough money to meet their everyday needs, and 1 in 4 households report having only just enough money. Those affected are primarily Māori and Pacific peoples, solo parents, children, and people with disabilities. Meanwhile, in 2013, just under 90,000 people in New Zealand said they can't have a conversation about everyday things in English. These people were most commonly speakers of Chinese languages, Samoan, or te reo Māori.

[1] Credit sales are agreements in which goods or services are received before they are paid off, and payments are made in instalments. Sometimes they are referred to as 'hire purchase' agreements (the legal terminology that was used before the CCCFA).

Responsible lending requirements introduced in 2015 are being reviewed

6. In June 2015 a number of changes were made to the CCCFA, which included new responsible lending requirements. This was in response to many lenders providing unaffordable or unsuitable loans to vulnerable consumers, and resulting social harms from this debt.

RESPONSIBLE LENDING OBLIGATIONS UNDER THE 2015 CCCFA REFORMS

Lenders must exercise the care, diligence, and skill of a responsible lender.

ASSISTANCE TO REACH INFORMED DECISIONS	SUITABILITY	AFFORDABILITY	ETHICAL AND REASONABLE TREATMENT	SAFEGUARDS FOR CONSUMERS SUBJECT TO REPOSSESSION
Lenders must assist borrowers and guarantors to reach an informed decision as to whether to enter into the agreement and its implications.	Lenders must make reasonable inquiries to be satisfied that the credit product likely meets the borrower's requirements and objectives.	Lenders must be satisfied that the borrower or guarantor will likely make the payments under the agreement without suffering substantial hardship. They must be able to meet essential day-to-day expenses and any other financial commitments.	Lenders must treat borrowers and guarantors reasonably and ethically throughout the life of the loan.	A number of new requirements were introduced for repossessions, including licensing of repossession agents.

7. Because the lender responsibilities are principles-based, the reforms also provided for the creation of the Responsible Lending Code (the Code) to provide practical guidance on ways to meet these obligations. Compliance with the Code is not the only way a lender can comply with the lender responsibility principles in the law. Nor is compliance with the Code deemed to be compliance with the lender responsibility principles in the law, but it can be used as evidence of compliance.

Review of the 2015 reforms

8. In December 2017 the Minister of Commerce and Consumer Affairs requested a review of these changes, to assess whether borrowers are better informed, whether predatory and irresponsible lending has reduced, and whether further steps are required to ensure responsible lending, particularly for vulnerable consumers.

9. This discussion paper sets out MBIE's findings from the review to date, based on desk-based research and interviews with stakeholders. While there have been some positive results from the 2015 reforms, it is clear that serious issues remain.

10. We'd like your feedback on the issues, and on ways to address them. Your submissions will inform MBIE's recommendations to Government on any further changes to the CCCFA.

Impact of 2015 responsible lending changes

11. The intended impacts of the responsible lending changes were:

    a. better informed decision making by consumers

    b. reduced predatory and irresponsible lending

    c. increased lender compliance with legal obligations under the CCCFA.

12. To help assess the impact of the reforms, we conducted a desk-based study of lender websites and discussions with discussions with 30 stakeholders. Together, these methods have provided a broad understanding about what is working from the 2015 changes, what is not working, and potential improvements which could be made.

What's working?

13. Stakeholders consistently reported that overall, the 2015 responsible lending changes have led to improvements in the information available to consumers, and in lender processes and decision-making. In particular:

What's working?	Observations
Lenders generally have an increased awareness of responsible lending requirements and practices	Lenders have reviewed and updated their processes and practices to meet the new requirements. Some lenders who already complied with the changes expended significant resources to better support the objectives of responsible lending.
There have been improvements in disclosure and advertising	Contracts are generally in plain language and much clearer, and lenders are generally transparent regarding their standard terms. These observations are supported by the results of our desk-based lender survey, which showed improvements in the proportion of lenders who • disclosed interest rates on their websites • fees on their websites • noted that circumstances were relevant to whether credit would be approved • used legible fine print.
Fewer repossessions	In general stakeholders are seeing fewer repossessions, and reduced harm and fewer problems when these do occur. Data from the Citizens Advice Bureau shows that total enquiries about debt recovery and repossession reduced by 10% over the four years between 2013/14 and 2016/17.
Specific prescriptive changes have had positive effects	For example, the cooling-off period for cancellation is being used by consumers to cancel contracts if they change their mind about a product.
Good enforcement work by the Commerce Commission	The Commerce Commission's work in prosecuting breaches of the CCCFA and developing a reporting process with consumer advocates was universally praised.

14. In addition, community service providers have reported that following the 2015 changes, consumer advocates are better able to recognise irresponsible lending because of the principles in the CCCFA, the Responsible Lending Code, and the advocacy work of the Commerce Commission.

What's not working?

15. Many stakeholders were greatly concerned about continued irresponsible and harmful lending. The areas that were seen as not working included:

What's not working?	Observations from stakeholders
The high cost of some consumer credit	There is evidence of some very high interest rates and fees for some credit products. This was seen to contribute to unmanageable levels of debt (particularly where these products were frequently used) or borrowers defaulted. Stakeholders commonly noted that high-cost credit was both readily available and normalised in low-income communities.
Significant levels of non-compliance	Across credit markets, there are inconsistent levels of compliance, and continued irresponsible lending by some lenders. Specific areas of significant non-compliance were in carrying out affordability assessments and in advertising practices. Stakeholders noted that the harm of irresponsible lending falls disproportionately on vulnerable consumers – and in particular, people in hardship. The observations regarding non-compliance and consumer harm are supported by the results of our desk-based lender survey, which indicate that a significant number of websites and advertising for lenders other than banks and credit unions still have required information missing.
Continued predatory behaviour by mobile traders	Mobile shopping trucks and traders making uninvited sales of goods on credit continue to target vulnerable consumers and generate unaffordable debts. Some of their contracts may fall outside the CCCFA.
Unreasonable fees	As part of the broader problem of non-compliance, we heard a range of concerns about the nature of fees charged, and their seemingly disproportionate amounts.

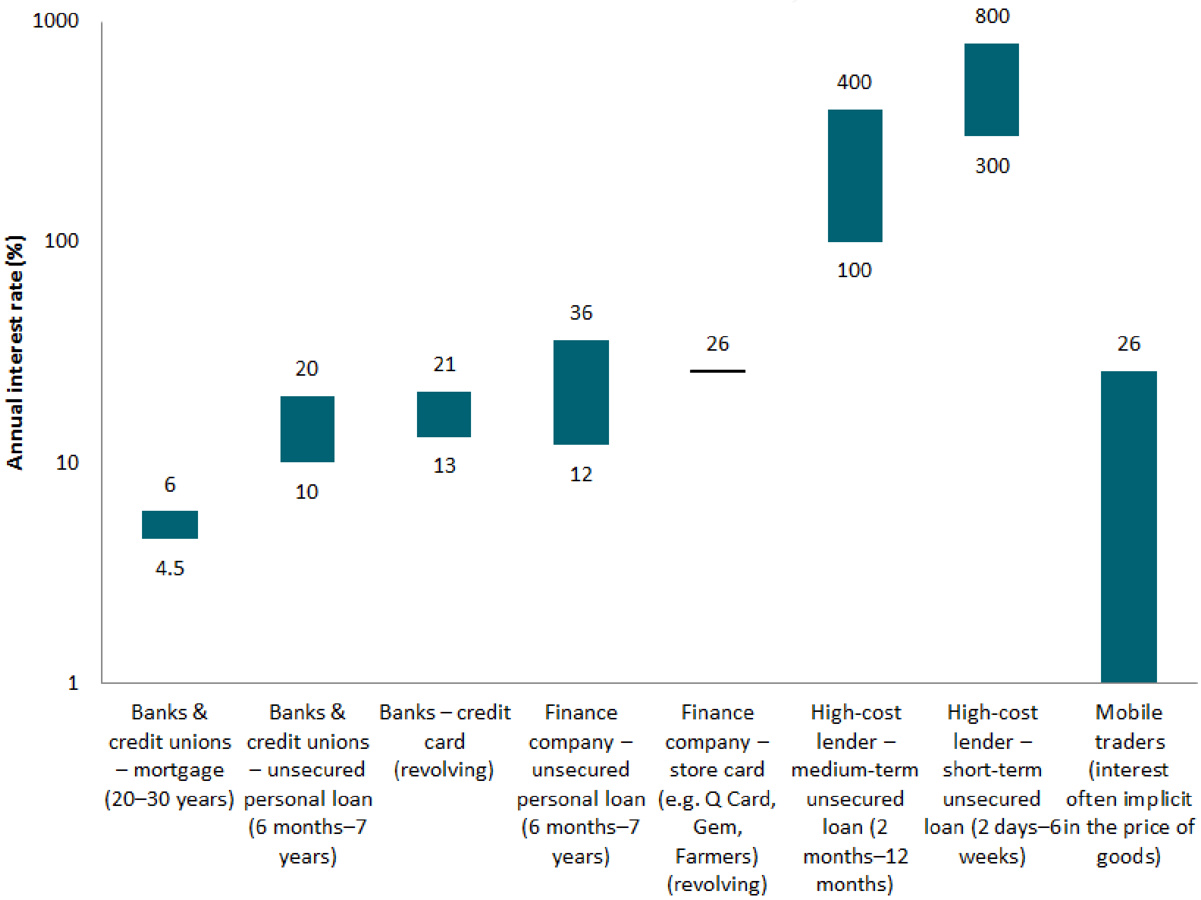
16. Stakeholders have also expressed concerns that there are insufficient alternatives to taking on high-cost credit for people who need loans for essentials.

17. Problems with consumer credit are common among people in hardship. The single biggest component of budgeting services client debt is consumer credit: 41% of the debt is from loans, credit cards and credit for retail goods. One social service provider that works with low income families advised that 95% of its client families (75% of which were Pacific people and 15% Māori) were carrying unaffordable debt. Meanwhile a Whānau Ora sub-provider working with Māori advised that the vast majority of their families struggled with hardship, 26% owed money to creditors and 43% had debts that were being pursued by a debt collection agency.

Issue 1: Excessive cost of some consumer credit agreements

18. Some lenders offer small loans over short timeframes. These credit products are referred to as 'high cost' on the basis of their high annual interest rates, or when compared against products offered by 'mainstream' lenders such as banks, credit unions and finance companies.

19. The chart below shows general terms and interest rates across different types of lending products in New Zealand. The rates are displayed in their annualised form to enable comparison. For loans with short terms (i.e. under a year) the total interest charges will be less than the annual interest rate, if payments are made on time, or if the lender voluntarily ceases to charge interest after a time.



20. There is a disjunction between most finance companies, which charge up to around 36% p.a., and high-cost lender rates that range from 100-400% p.a. for a 3-12 month loan, and are many hundreds of percent interest p.a. for a short (under 6 week) loan.

21. The extent to which the cost of such loans is a problem is much debated in New Zealand and internationally.

22. While high-cost lenders offer some products where there are no 'mainstream' loans of an equivalent amount and term available, there are situations where similar loans can be obtained from the two different types of lenders. For example, one finance company offers a $2,000 12-month loan for 12.99%–29.99% p.a. interest, but a high-cost lender charges 120% p.a. for a similar loan.[2]

WHY DO BORROWERS TAKE OUT HIGH-COST LOANS? **There are many reasons for taking out high-cost loans.[3]**
Some borrowers only want loans for **short timeframes or small amounts.** These are products which generally aren't available from 'mainstream' lenders.
Some borrowers **do not trust mainstream lenders, or find their processes too bureaucratic, impersonal, inconvenient or slow** and are therefore happy to pay a premium to avoid them.
Some borrowers prefer the **independence and privacy** of a loan over seeking assistance from Work and Income, a charity, or family or friends.
Some borrowers **cannot obtain a loan or credit elsewhere** due to their credit histories**.**
Some borrowers have become **'addicted' to credit.** Access to money and credit has strong social associations with achievement, freedom, control, and power, perhaps especially for people who have experienced hardship.
Some borrowers may take out high-cost loans due to a **lack of awareness** of other options.

23. Potential problems raised with high-cost loans are:

    a. ***Financial harm from frequent use of high-cost loans:*** borrowers may make substantial payments in interest and fees, making them poorer and more vulnerable to financial shocks.

[2] An establishment fee of $240 for the finance company loan means the cost of credit is higher than first appears from the interest rate alone, but it is still less than half that charged by the high-cost lender.
[3] For a detailed discussion see Speaking for Ourselves: The truth about what keeps people in poverty from those who live it – a summary report from the Auckland City Mission Family 100 Research Project at https://www.aucklandcitymission.org.nz/wp-content/uploads/2016/05/Auckland-City-Mission-Family100-Speaking-for-Ourselves.pdf (accessed May 2018). See also the literature review in Shevellar, Lynda and Marston, Gregory (2011) Exploring the role of fringe lenders in the lives of Queenslanders. *Australian Journal of Social Issues*, *46* 2: 205-222.

b. ***Debt spirals:*** consumers who default on high-cost loans, or seek loan extensions, can quickly end up with unmanageable debt and in financial hardship. In some cases the interest and fees continue to accrue indefinitely.

c. ***Uncompetitive rates:*** interest rates or fees may be viewed as 'excessive' in the sense that they are much higher than would be expected in an informed, competitive market.

24. Low-income borrowers using high-cost loans as a last resort, or who feel a compulsion to borrow, are at greatest risk of harm. In recognition of this risk, some high-cost lenders told us they have eligibility criteria that exclude people who don't hold ongoing employment or have low incomes from borrowing. Some high-cost lenders have also developed voluntary cost-capping policies, and processes for identifying and preventing repeated use of loans by the same borrower.

25. Beyond the harms that may be caused by high-cost lending itself, high-cost lenders appear to be a significant source of irresponsible lending, both in New Zealand and overseas. A common view from stakeholders was that the ability the charge high interest rates means that lenders can be less scrupulous about who they lend money to. These problems are discussed further under Issue 2. It is important to note that all types of lenders have been reported to engage in irresponsible lending from time to time, and some high-cost lenders have told us they take a rigorous approach to comply with lender responsibilities.

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

Options for addressing high interest and fees

26. Caps on interest and fees (for all or some lenders) have the potential to address the excessive cost of some consumer credit agreements. To the extent that high-cost lenders are a disproportionate source of non-compliance with lender responsibilities, interest and fee caps could also contribute to addressing non-compliance issues (discussed in Issue 2).

27. We discuss three options for interest and fee caps:

a. ***Cap Option A:*** limit the total accumulation of interest and fees over the life of the loan to 100% of the original loan principal. This option would only apply to high-cost lenders, and would aim prevent unmanageable debt and financial hardship from accumulating large debts from a small loan.

b. ***Cap Option B:*** Limit the interest rate and fees (calculated together) to 200–300% per annum, as well as limiting total accumulation of interest and fees over the life of the loan to 100% of the original loan principal.

c. ***Cap Option C:*** Set a low interest rate cap to prohibit high-cost lending. The interest rate and fees (calculated together) would be limited to 30%–50% per annum.

28. Below we set out the various options in detail, along with our assessment of their costs and benefits. At the end of this chapter we provide a comparative table of the options.

Cap Option A: limit the accumulation of interest and fees

29. As discussed above, a key problem with high interest rates and fees is that consumers who default on high-cost loans, or seek loan extensions, can end up with unmanageable debt and in financial hardship, even if the original loan was affordable.

30. Under Option A, interest and fees over the life of the loan would be limited to 100% of the original loan principal. This option would only apply to high-cost lenders (to be defined).

Potential extensions

31. While Cap Option A limits extensions and refinancing of loans, it does not address problems where borrowers in default receive new loans that are unrelated to the original loan, or make frequent and inadvisable use of high-cost loans.

32. A further step could be a prohibition on offering a high-cost loan to a person who has defaulted on an existing high-cost loan (or a loan that refinances that loan), and has not yet repaid it. Going further still, there could be a limit of one high-cost loan per borrower, and a cooling-off period between repayment of a high-cost loan and obtaining a new high-cost loan. The cooling off period could be, for example, 30–90 days, and would apply to new loans from the same lender or a different lender.

2	Do you support any of the extensions of Cap Option A? What would be the impact of these extensions on borrowers, lenders and the credit markets? Do you have any information or data that would support an assessment of the impact of these extensions?

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

33. Beyond limiting the accumulation of interest and fees, a further step for addressing harms associated with high-cost lending is to directly limit the level of the interest and fees that can be charged.

34. Under Option B:

a. Interest and fees would be limited to an equivalent interest rate of 200–300%.[4]

b. There would be a prohibition on default interest exceeding the normal interest rate, and a limit on default fees to $30 over the life of the contract.

c. The same limits on accumulation of interest and fees would apply as in Option A.

35. This option would only apply to high-cost lenders (to be defined).

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

36. Under this option, interest and fees would be aggregated into an equivalent interest rate and capped at a specific rate, perhaps between 30% and 50% per annum. This would apply to all lenders providing consumer credit contracts.

37. Such an interest rate cap would effectively prohibit payday lending and other commercial short-term lending of relatively small amounts of money.

[4] The equivalent interest rate is the annual interest rate that would be need to be charged if there were no fees, for the lender to receive the same repayments from the borrower. This assumes that all payments are made on time and the debt is repaid over the original term. Calculations are based on weekly payments and no compounding of daily interest.

Examples

HOW WOULD THE CAPS WORK IN PRACTICE?

Examples of taking out a high-cost loan under each option.[5]

STATUS QUO	CAP OPTION A	CAP OPTION B	CAP OPTION C
A borrower takes out a high-cost loan: • *Principal* $500 • *Interest* 600% • *Term* 28 days (four weekly payments)	A borrower takes out a high-cost loan: • *Principal* $500 • *Interest* 600% • *Term* 28 days (four weekly payments)	A borrower takes out a high-cost loan: • *Principal* $500 • *Interest* 250% • *Term* 28 days (four weekly payments)	High-cost loans are prohibited.
BEST CASE • The borrower makes 4 weekly payments of **$162.91**. • Total payments are **$651.64**.	**BEST CASE** (same as status quo) • The borrower makes 4 weekly payments of **$162.91**. • Total payments are **$651.64**.	**BEST CASE** • The borrower makes 4 payments of **$140.33**. • Total payments **$561.33**.	**BEST CASE** The borrower decides not to borrow or obtains alternative finance, e.g.: • overdraft or credit card from bank or credit union, or a loan from a social lending service • loan from friends & family • temporary Work & Income support.
WORST CASE • The borrower makes no payments. • After **three months**, the borrower owes **$1,924.65**. • After just over **six months**, the borrower owes **$9,319.45**.	**WORST CASE** • The borrower makes no payments. • The loan balance is capped at **$1,000**, which is reached after **7 weeks**.	**WORST CASE** • The borrower makes no payments. • The loan balance is capped at **$1,000**, which is reached after **3.5 months**.	**WORST CASE** • The borrower obtains a loan from an illegal lender, or • The borrower takes out a larger loan for a longer term.

[5] These simplified examples don't include fees, such as establishment fees and default fees, and interest is calculated daily but only added to the loan at the end of each week. Fees and daily compounding interest increase some of the amounts.

Costs and benefits of options for capping interest and fees

38. A table summarising the pros and cons of the cap options is included below.

Option	Benefits	Costs
Cap Option A: limit the accumulation of interest and fees	• Limits the extent to which borrowers accumulate large debts from a single loan. • Fewer borrowers would accumulate unmanaged debt and get into financial hardship. • Borrowers would pay slightly less in interest and fees overall.	• Some high-cost lenders would lose revenue from interest and fees paid by defaulting borrowers. • Would limit the offering of loan extensions. It may result in borrowers instead seeking a new loan from a different lender, and using it to repay the original loan.
Cap Option B: reduce the highest interest rates and limit accumulation of interest and fees	• Borrowers using high-cost lending services would pay significantly less in interest and fees. • Likely to contribute to lower rates of default and reduced hardship as a result of high-cost lending.	• Depending on the level of the cap, many high-cost lenders may close. • Some harm may be caused to borrowers with genuinely short-term cash flow difficulties, as lenders close and tighten lending criteria or offer fewer short-term loans. • Could facilitate price coordination, leading some high-cost lenders to raise interest rates up to the level of the cap. • Possible that the cap could increase illegal lending (from lenders charging higher interest rates)
Cap Option C: set a low interest rate cap to eliminate high-cost lending	• Greatly reduces hardship caused by high-cost lending. • Some evidence that eliminating high-cost lending can be beneficial overall.	• Likely to be harm to individuals and families with genuinely short-term cash flow difficulties. • The closure of high-cost lending businesses. Some lenders may alter their business models to offer much longer term loans. • Possibility that the cap may facilitate price coordination, leading some mainstream finance companies to raise interest rates up to the level of the cap. • Possibility that the cap may increase illegal lending, resulting in weaker protections for borrowers using these services.

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

Issue 2: Continued irresponsible lending and other non-compliance

39. From our stakeholder interviews and desk-based research, there appear to be unacceptable rates of non-compliance with a range of CCCFA obligations, particularly the responsible lending obligations and public disclosure requirements introduced in 2015. This is causing considerable harm to vulnerable borrowers. Consumer groups, regulators, dispute resolution schemes and some lenders have reported:

    a. It is common for some lenders to perform only superficial testing of loan affordability and accept income and expense information provided by borrowers without proper questioning or verification, even where it is plainly incomplete or incorrect. Subsequent loans may be quickly approved (e.g. following an application by text message) and not subject to further checking of affordability, even 9 months after the original loan.

    b. There is aggressive advertising of high-cost loans to consumers who have previously repaid them, raising questions about whether some lenders are meeting their requirements to advertise responsibly. This includes upselling of loans (e.g. borrowers being encouraged to borrow $2,000 when they have applied for $1,000 because they can afford it).

    c. Borrowers are often unaware when they have purchased insurance with vehicle loans, suggesting they may not be adequately assisted to make an informed decision.

    d. Guarantors are signing guarantees they do not understand, suggesting that lenders are not adequately assisting guarantors to make an informed decision (e.g. by requiring that they obtain independent legal advice).

40. Issues with a lack of clarity or specificity may be contributing to the non-compliance issues identified above. Some lender stakeholders said that, notwithstanding the Responsible Lending Code, there is considerable uncertainty about how to comply with the lender responsibilities, or what is an acceptable standard. Consumer advocates have also expressed concerns that the principles-based nature of the lender responsibilities and Responsible Lending Code makes it difficult to know what is prohibited, and when to complain about conduct to the Commerce Commission or dispute resolution schemes.

Summary of options for addressing non-compliance

41. To address non-compliance problems, a range of options are discussed:

    a. ***Increased registration or licensing requirements for lenders:*** These options comprise expanded powers to deregister creditors and ban directors, a 'fit and proper person' test for directors and senior managers of creditors, or a comprehensive creditor licensing system.

    b. ***Strengthening enforcement and penalties for irresponsible lending:*** These options include penalties and clearer civil liability for responsible lending breaches, directors' duties, and a substantiation obligation for lenders. There is also the potential to increase resourcing of the Commerce Commission through an increased industry levy on creditors. Another approach is to require creditors to work with consumers' advocates if asked to do so, in good faith.

    c. ***Introducing more prescriptive requirements for affordability and advertising***.

42. These options can be implemented independent of one another. If used in combination they will have a cumulative effect. Some of them (such as options for strengthening enforcement) could increase the impact of other options.

Options for increasing lender registration requirements

43. There are low regulatory barriers to registration and entry into the credit markets. Currently all lenders are required to be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Registration means that a lender has satisfied certain requirements, including not having been convicted in the last five years of crimes involving dishonesty and not being an undischarged bankrupt. Registration also requires lenders to be a member of an approved dispute resolution scheme so as to provide consumers access to redress.

44. We understand that it has proven resource intensive and difficult in practice to obtain banning orders for lenders and their directors and senior managers. Section 108 of the CCCFA currently enables the District Court to order a person not to provide consumer credit or take part in management of a company providing consumer credit. The order can be made if the person meets criteria, such as having failed more than once to comply with any of the provisions of the CCCFA.

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

45. Under this option, the Commerce Commission would be empowered to direct the Companies Office (as the Registrar) to deregister a lender providing consumer credit, if it is satisfied that the lender is causing or is likely to cause harm in their lending conduct to

consumers in the future. In deciding whether a lender is causing or is likely to cause harm to consumers in the future, the Commerce Commission would be required to take into account steps taken by the lender to improve practices and prevent future contraventions.

46. Section 108 would be replaced by a new management banning order power applying to individuals. This would provide that a person can be prohibited from being the director or manager of a lender if the person has repeatedly contravened relevant legislation and the court is satisfied that the order is necessary to protect the public.

Registration Option B: introduce fit and proper person test in registration of lenders

47. A further step would be to require directors and senior managers of consumer credit providers to show they are fit and proper persons, as part of registration on the FSPR. This would aim to prevent businesses led by individuals who are at higher risk of engaging in irresponsible lending, from acting as lenders (rather than waiting for the law to be breached before considering their ongoing fitness to lend).

48. Exemptions would be provided for lenders who are already licensed and regulated under a separate fit and proper persons test for directors and senior managers. This currently includes registered banks, licensed non-bank deposit-takers, and market services licensees under the Financial Markets Conduct Act. The decision of the regulator would be subject to court appeal.

Registration Option C: a comprehensive creditor licensing system

49. A more extensive option is comprehensive licensing for lenders providing consumer credit. This option could build on the fit and proper person test for directors and senior managers proposed in Registration Option B, but include additional requirements that creditors must meet before receiving a licence and being registered on the FSP.

50. The requirements to obtain a licence under the comprehensive licensing system could be that the regulator is satisfied that—

    a. The applicant's directors, senior managers, and proposed directors and senior managers are fit and proper persons to hold their respective positions.

    b. The applicant will have adequate systems and procedures to be a responsible lender and otherwise comply with the CCCFA.

    c. There is no reason to believe that the applicant is likely to contravene any obligations under the CCCFA.

51. Licences could be granted under conditions, and the decision of the regulator would be subject to court appeal.

Options for strengthening enforcement and penalties for irresponsible lending

52. A major theme of feedback received from both industry and consumer stakeholders is that although the Commerce Commission has been active in relation to lending, there has been insufficient enforcement of the lender responsibilities. A number of stakeholders have also suggested that there are inadequate incentives for compliance.

53. The Commerce Commission issued no warnings, settlements or prosecutions for breaches of the lender responsibilities between the reforms coming into force in June 2015 and February 2018. A warning was issued to Dealer Finance Limited on 19 March 2018, and proceedings filed against Ferratum New Zealand Limited on 1 June 2018.

Enforcement Option A: civil pecuniary penalties, statutory damages and expanded injunction orders for breach of lender responsibilities

54. Currently there are no penalties for breaches of the lender responsibilities. The courts can order compensation for any loss to borrowers, and issue injunctions, but there are no offences or civil pecuniary penalties. The lack of penalties means there are relatively weak incentives to comply with the lender responsibilities. This also affects the incentives for the Commerce Commission to take resource-intensive enforcement action.

55. Under this option, breaches of lender responsibilities would attract civil pecuniary penalties and statutory damages. Civil pecuniary penalties would provide stronger incentives for creditors to comply with lender responsibilities. Statutory damages would make it easier for borrowers to claim compensation where lender responsibilities were breached.

56. The maximum civil pecuniary penalties could be $200,000 for an individual or $600,000 for a body corporate. Where lending has been made in breach of suitability or affordability requirements, a standard level of statutory damages would be paid equal to the interest and fees charged. A court could reduce statutory damages if it considered it just and equitable to do so.

Enforcement Option B: directors' duties

57. Unlike some other financial markets regimes, penalties and other liability across the CCCFA sits almost exclusively with the creditor and other body corporates with limited liability. This means that duties and incentives on directors and senior managers to comply can be relatively weak – particularly if the lender is small and lightly capitalised. In some cases, penalties and compensation claims can be avoided through voluntary liquidations and the creation of new 'phoenix' companies.

58. Under Option B, directors would be subject to duties to take reasonable steps to ensure that the creditor complies with its' CCCFA obligations. Directors who breached duties would be subject to civil pecuniary penalties and would be liable for compensation.

59. Directors could fulfil their duties by ensuring the creditor has adequate policies for compliance with the CCCFA, and adequate systems for implementing those policies and detecting and correcting breaches. Directors with more direct involvement in the day-to-day management of the creditor (e.g. small creditors with a managing director) may fulfil their duties by implementing appropriate systems themselves, ensuring that staff are adequately trained and regularly checking compliance and taking corrective action.

60. A related issue is whether duties should only be applied to directors, or should also be applied to senior managers – those whose position allows them to exercise significant influence over the management or administration of the creditor (for example, a chief executive or a chief financial officer). The scope of those duties would be limited by the scope of the person's role. An extension to senior managers may better target duties at persons making important strategic and day-to-day decisions, rather than on directors with broad governance responsibilities.

6	If directors have duties to take reasonable steps to ensure that the creditor complies with its' CCCFA obligations, should any duties apply to senior managers?

Enforcement Option C: substantiation obligation for lenders

61. This option would involve creating a requirement that lenders must substantiate their affordability and suitability assessments, and supply a copy on request to the borrower (or their agent) or the Commerce Commission. This would require lenders to document their assessment processes and the evidence relied upon, and would put the burden on lenders to pro-actively demonstrate that they are conducting all the necessary inquiries.

Enforcement Option D: increase industry levy on creditors to help fund advocacy, monitoring and enforcement of CCCFA

62. Enforcement by the Commerce Commission is undertaken under its Crown-funded "Enforcement of General Market Regulation" appropriation – $17.5 million in 2016/17. This is used for administration, education and enforcement of the Commerce Act 1986, the Fair Trading Act 1986, and the CCCFA. From this appropriation, $TBC was spent on CCCFA activities in 2016/17.

63. There has been a strong call by almost all stakeholders to increase advocacy, monitoring, and enforcement activity by the Commerce Commission. This is expected to reduce irresponsible lending, thereby reducing consumer harm and increasing the competitiveness and efficiency of credit markets.

64. Increasing these activities will require more resources and funding. Currently all funding for credit regulation is sourced from the Crown (mostly through general taxation), which has been increasing its contribution. Creditors (along with a number of other financial service providers) currently pay an annual levy of $460 (plus GST), which helps to fund the Financial Markets Authority.

65. Under this option, the levy on creditors providing consumer credit would be increased to help to fund increased regulatory activity by the Commerce Commission.

66. An increased industry levy would reflect the fact that both borrowers *and* responsible lenders benefit from well-regulated credit markets. A number of lenders have pointed to examples of a lack of regulator activity as creating an ‘uneven playing field’. Funding enforcement and reducing non-compliance would make it easier for compliant businesses to compete fairly. There is strong precedent for using this model; industry levies fund a significant proportion of the activities of the FMA (another enforcement agency), the XRB, and the Companies Office.

Enforcement Option E: require creditors and their agents to work with consumers’ advocates if asked to do so, and in good faith

67. Under this option, when a consumer requests that the creditor or their agent work directly with an advocate – for example a budget advisor or a lawyer – they will be required to do so in good faith.

Options for introducing more prescriptive requirements for affordability assessments and advertising

68. The Responsible Lending Code (the Code) is made under the CCCFA to provide guidance on how to satisfy the responsible lending requirements contained within the CCCFA. The CCCFA provides that evidence of a lender's compliance with the provisions of the Responsible Lending Code is to be treated as evidence of compliance with the lender responsibility principles.

69. The Code is not binding, meaning that lenders can satisfy the lender responsibility principles in other ways not explicitly mentioned in the Code.

70. While there are significant advantages to principles-based regulation, an overreliance on such regulation has been identified by stakeholders as contributing to problems described above with non-compliance and a lack of clarity about legal obligations.

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

71. Lenders are currently required to make reasonable affordability inquiries before entering into a credit contract. This is so they can be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship. The Responsible Lending Code offers some guidance on how this requirement can be met.

72. Under this option, mandatory requirements would be introduced for some types of lenders and loans to assess affordability in accordance with a defined procedure. This could be based on calculating the borrower's uncommitted income, which would be based on information verified by a review of bank transactions and other documentation.

73. This could be required for loans where there are greater concerns about non-compliance, such as vehicle loans and high-cost loans.

7	If there are to be more prescriptive requirements for conducting affordability assessments, what types of lenders or loans should these apply to?

Ability for lenders to rely on information provided by the borrower

74. Section 9C(7) of the CCCFA provides that for affordability and suitability requirements, "the lender may rely on information provided by the borrower or guarantor unless the lender has reasonable grounds to believe the information is not reliable".

75. The threshold of "reasonable grounds" is high, and in practice this means that lenders are permitted to accept borrower statements about income and expenses at face value, unless they are inconsistent with other information the lender holds about the borrower, or are unrealistic.[6] This is likely to be a barrier to requiring lenders to undertake reasonable inquiries to assess the affordability of repayments.

76. As part of considering more prescriptive affordability requirements, we are considering whether this provision should be removed, or significantly narrowed. Even without section 9C(7) most information provided by the borrower would generally not need to be verified. Whether information needs to be verified as part of reasonable inquiries would depend on the importance of the information, and the cost and difficulty of verifying the information. Further guidance could be provided through the Responsible Lending Code.

8	Should there be any change to the requirement that lenders can rely on information provided by the borrower unless the lender has reasonable grounds to believe the information is not reliable? What would be the impact of such a change on borrowers, lenders and the credit markets?

[6] The Responsible Lending Code 5.16–5.17 provides more guidance on this.

Responsibility Option B: introduce more prescriptive requirements for advertising

77. Section 3 of the Responsible Lending Code provides guidance on how lenders can meet their responsibility to advertise responsibly. This includes guidance on particular practices, such as displaying an annual percentage interest rate and the total amount payable under the agreement (if ascertainable). Specific guidance is provided for high-cost credit agreements, such as risk warnings, and steps that should be taken if lenders use celebrity endorsements.

78. Our desk based review of lender websites has found that the Code's guidance on advertising is poorly adhered to by some lenders. For example, risk warnings are rarely used. They were only identified in around 35% of high-cost lender websites and 15% of high-cost lender newspaper advertisements. Under this option, the current Responsible Lending Code guidance for advertising would be made mandatory (with any necessary modifications).

Are further steps on advertising necessary?

79. Some stakeholders suggested that elements such as risk warnings should be extended beyond high-cost lending to a wider range of credit products, or that advertising for high-cost lending should be prohibited. We would welcome feedback on whether any changes to the advertising provisions of the Responsible Lending Code – whether they remain non-binding or become mandatory – should be considered.

9	Do you consider there should be any changes to the current advertising requirements in the Responsible Lending Code? If so, what would be the impact of those changes on borrowers, lenders and the credit markets?

Responsibility Option C: require disclosure to be in the same language as advertising

80. In some cases, advertising is provided in a language other than English, but the credit contract is provided in English. Borrowers for whom English is not their first language are likely to be vulnerable in this circumstance. The Responsible Lending Code provides that where a lender reasonably suspects that the borrower does not have a good understanding of the English language, a lender should provide, or refer the borrower to, alternative methods or mechanisms for receiving the relevant information.

81. Under this option, there would be a mandatory requirement that disclosure statements be provided in the language that the borrower is most comfortable communicating in, if the lender advertised in that language. This change would aim to assist borrowers and guarantors in making informed decisions.

Costs and benefits of options to reduce irresponsible lending and other non-compliance

82. A table summarising the pros and cons of the registration, enforcement and responsibility options is included below. Of the three sets of options discussed in this chapter, our initial view is that strengthening enforcement and penalties for irresponsible lending is likely to have the largest impact on reducing non-compliance. A comprehensive creditor licensing system (Registration Option C) is also likely to have a significant impact on irresponsible lending and non-compliance, although it also comes with large and difficult-to-measure costs and would need careful consideration.

Option	Benefits	Costs
Registration Option A: expanded powers to deregister lenders and ban directors from the industry	• Reduction in number of repeat offenders acting as lenders. • Small reduction in irresponsible lending and consumer harm.	• Some lenders may take a more risk averse approach to lending. • More bans and deregistrations may force some lenders 'underground' where conduct is much harder to monitor. • Some concern may arise around providing the Commerce Commission with the power to deregister (although an appeal to the courts would be available).
Registration Option B: fit and proper person registration test	• Reduces the participation in the credit market of individuals with a history of misconduct or dishonesty. • Small reduction in irresponsible lending and non-compliance.	• Small-moderate increase in compliance costs across many lenders. • Lenders not meeting the requirements may operate 'underground' where conduct is much harder to monitor.
Registration Option C: comprehensive creditor licensing system	• Reduces participation in the credit markets of individuals with a history of misconduct or dishonesty, and creditors who are unlikely to comply. • More robust lender compliance systems. • More effective monitoring of the industry, and more flexible means for addressing non-compliance. • Moderate reduction in irresponsible lending and non-compliance.	• Relatively high compliance costs on affected lenders, which may be passed on to borrowers in the form of higher interest rates. • Lenders not meeting the requirements may operate 'underground' where conduct is much harder to monitor.
Enforcement Option A: pecuniary penalties, statutory damages and injunction orders for breaches	• Greater deterrence and streamlined enforcement. • Damages increase the incentives for consumers to take action where breaches occur. • Moderate reduction in irresponsible lending.	• Pecuniary penalties may increase risk aversion among lenders and thus increase compliance costs. • Penalties may reduce incentives for Commerce Commission to seek compensation for borrowers.
Enforcement Option B: directors' duties	• Strengthens incentives for directors to ensure the creditor complies with the CCCFA. • Moderate reduction in irresponsible lending and non-compliance.	• May create disincentives for professional directors to serve on creditor boards. • May raise the price of directors' liability insurance and lead to more risk-averse creditor governance.
Enforcement Option C: substantiation obligation for lenders	• Increases the ability to identify breaches which may act as a deterrent to non-compliance. • Borrowers would be more likely to obtain compensation from non-compliant lenders.	• Additional compliance costs for lenders who are not currently documenting these processes (although most compliant lenders will already record this information so the impact may be relatively low). • Some costs for lenders responding to substantiation requests.

	• Small reduction in irresponsible lending and non-compliance.	
Enforcement Option D: increase industry levy to fund advocacy, monitoring and enforcement	• The Commerce Commission would be able to increase its advocacy, monitoring and enforcement activities. • Moderate reduction in irresponsible lending and non-compliance.	• Direct costs on lenders which may be passed onto borrowers in higher interest rates.
Enforcement Option E: require creditors to work with consumers' advocates if asked	• Reduces the likelihood of consumer harm as advocates help to ensure the law is adhered to. • May improve self-enforcement of consumer rights.	• Some compliance costs on creditors to increase engagement with advocates. • Not all consumers have access to advocates. • Advocates are more likely to report breaches to the Commerce Commission and this would increase enforcement activity and costs.
Responsibility Option A: introduce more prescriptive requirements for conducting affordability assessments	• Increases the ability to identify breaches and this may act as a deterrent to non-compliance. • Provides clarity about what assessments and evidence is required to comply with affordability responsibilities. • Small reduction in irresponsible lending.	• Some currently compliant lenders may incur additional compliance costs to the extent that the new requirements were inconsistent with their existing practices.
Responsibility Option B: introduce more prescriptive requirements for advertising	• Small reduction in irresponsible lending.	• Some currently compliant lenders may incur additional compliance costs to the extent that the new requirements were inconsistent with their existing practices.
Responsibility Option C: require disclosure to be in the same language as advertising	• Some vulnerable consumers would be more likely to understand disclosure documents and make better informed decisions. • Small reduction in incentives for predatory lending that is targeted at vulnerable consumers who don't understand contractual terms	• Costs to lenders from producing disclosure statements in a number of languages (where they do not do so already) • It would be more difficult to monitor compliance when disclosure is in languages other than English.

10	Do you agree with our assessment of the costs and benefits of the options to reduce irresponsible lending and other non-compliance? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
11	Do you have any suggestions for the design of options for reducing irresponsible lending and other non-compliance? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
12	Which options for reducing irresponsible lending and other non-compliance would you support? Which would you not support? Please explain how you made your assessment.

Issue 3: Continued predatory behaviour by mobile traders

83. Mobile traders (for the purposes of this discussion paper) are businesses that do not have fixed retail premises and sell predominantly or exclusively on credit or other deferred payment terms. Some of these traders operate mobile shops, usually from trucks, while others employ sales staff who sell goods door-to-door using catalogues and brochures.

84. Mobile traders are often lenders for the purposes of the CCCFA, where they sell goods or services through consumer credit contracts.

85. Stakeholders commonly raised the following concerns about mobile traders:

    a. ***The high cost of purchasing goods with some mobile traders:*** the Commerce Commission's investigation found that many products are sold at prices that are significantly higher than the cash prices for a comparable product purchased from a mainstream retailer.[7] In many cases high costs of borrowing are being incorporated into these prices, rather than being charged explicitly as interest or credit fees. This makes them more difficult to regulate under the CCCFA, and in some cases contracts may fall outside the CCCFA altogether.

    b. ***High-rates of non-compliance with consumer protection requirements:*** the Commerce Commission's investigation into 32 mobile traders found that 31 of the businesses did not, to varying extents, comply with all of their obligations under the CCCFA and Fair Trading Act (FTA). Following the report, 29 were issued with compliance advice. To date, 13 have been prosecuted for CCCFA and FTA breaches.

    c. ***Irresponsible and unconscionable behaviour:*** These include obtaining multiple signed direct debit forms to maintain payments even if the borrower cancels a direct debit, having obscure terms in the contract that mean that customer payments continue after the item is fully paid (to build an account credit), refund policies which require a home visit (and for which a home visit fee is charged), and traders retaining the money paid by customers who stop making payments (even if no goods have been supplied).

86. Stakeholders indicated that these three problems have continued, despite the legislative changes in 2015 and concerted monitoring and enforcement activity by the Commerce Commission.

[7] Mobile Trader 2014/2015 Report, Page 9 http://www.comcom.govt.nz/the-commission/consumer-reports/mobile-trader-201415-project/

Options to address predatory and irresponsible behaviour by mobile traders

87. Many of the options to address issues with mobile traders are the same as for other lenders covered by the CCCFA. These include options for increasing creditor registration requirements, strengthening enforcement and penalties for irresponsible lending, more prescriptive requirements regarding affordability and advertising and options to address unreasonable fees.

88. In addition, there are further options below to extend coverage of the CCCFA to more mobile traders selling goods on credit.

Options to address credit sales falling outside the CCCFA

89. Some mobile traders (and also some other businesses[8]) provide purchase agreements for goods which are received up-front and paid for in instalments, but there are no explicit interest or credit fees and the creditor does not take a security interest. The absence of interest, credit fees or a security interest may mean these do not fall within the definition of 'consumer credit contract'.[9]

90. If these contracts fall outside the CCCFA, these firms are not required to lend responsibly or comply with other CCCFA obligations.

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

91. Under this option, any credit contract charging default fees would be a "consumer credit contract" and thus regulated by the CCCFA.

92. This would provide consumers with CCCFA protections in a wider range of circumstances. We would be interested in feedback on what contracts would be excluded by this, and what types of contracts might be inappropriately captured by this change.

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

93. Under this option, the CCCFA would prohibit credit sales of personal, household and domestic goods and services where the price of the goods (excluding interest and fees)

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[8] For example, Afterpay, Laybuy, PartPay and Oxipay.

[9] Although there is an argument, yet to be tested in New Zealand courts, for there being implicit credit fees in some of these contracts.

exceeds the cash price of the goods or services. The cash price would be defined along the lines of the following:

a. the lowest price at which a person could have purchased those goods or services from the supplier, on the basis of payment in full at the time the contract was made, or

b. the fair market value of those goods or services at the time the contract was made

whichever is the lesser.

94. The effect of this is that when goods or services are sold on credit, any price above the cash price of the goods would need to be charged as interest. An example of how this would work is shown below.

Currently a trader could sell…	Under the proposal, this would need to be restructured as follows…
iPhone 8	iPhone 8
Price $4,000 (c.f. price from Apple $1,249)	Price $1,249
0% interest	101.80% interest
156 payments of $25.64	156 payments of $25.64 No change to actual payments

95. This change would enable any interest rate caps (under Issue 1) to be applied to mobile traders. We would be interested in feedback on any situations where consumer goods and services might be sold on credit above a cash price or fair market value, but these should not be considered consumer credit contracts.

Costs and benefits of options for scope of CCCFA

Option	Benefits	Costs
Scope Option A: include credit contracts that charge default fees in the definition of consumer credit contract	• CCCFA protections in a wider range of circumstances.	• Lenders who were newly captured by the amended definition would face significantly higher compliance costs. • Borrowers using newly captured lenders would face longer and more onerous credit application processes.
Scope Option B: prohibit the price of goods or services sold on credit from exceeding the cash price	• Captures all goods where costs of borrowing are incorporated into the price. • More transparent costs of borrowing. • Any interest rate caps (as in Option 1B and 1C), would apply to these contracts. • Consumers are likely to be better informed and better protected from harm.	• A number of lenders who have previously been selling goods or services on credit above the cash price would face significantly higher compliance costs. • Unclear if there are situations where consumer goods and services might be sold on credit at above a cash price or fair market value, but these should not be considered consumer credit contracts.

13	Do you agree with our assessment of the costs and benefits of the options for covering additional credit contracts under the CCCFA? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
14	Do you have any suggestions for the design of options for covering additional credit contracts under the CCCFA? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
15	Which options for changes to cover additional credit contracts would you support? Which would you not support? Please explain how you made your assessment.

Issue 4: Unreasonable fees

96. We have heard a range of concerns about creditors continuing to charge excessive fees. Fees appear to be a particular issue across a wide range of lenders, not just the high-cost lenders discussed in Issue 1.

97. The CCCFA provides that a credit fee or default fee must not be “unreasonable”. Currently the main (but not the only) test for the reasonableness of fees is that they recover costs that are closely relevant to the transactional activity (such as processing a loan application) that they are being charged for. They cannot, for example, cover unrelated costs or contribute to profits.

98. We have been told that there are difficulties enforcing the prohibition on unreasonable fees. The burden falls to the Commerce Commission or the borrower to prove that a fee is unreasonable. Some lenders are not conducting and documenting thorough cost calculations, which makes it time-consuming and costly to check whether or not a particular fee is reasonable.

99. We have also heard that there is a lack of clarity about when a fee is unreasonable. The Supreme Court’s judgement in Sportzone/MTF has clarified the fees provisions to some extent. However the court noted that the test of “reasonableness” is imprecise, difficult to apply, and that often a creditor will need to set its fees in circumstances where it may not have precise cost information.

Options for addressing unreasonable fees

Fees Option A: require lenders to substantiate reasonableness of fees

100. This option would require lenders to have reasonable grounds, when setting fees, that the fee is not unreasonable. This would require them to calculate fees by reference to the costs of the activities that are being recovered, and to keep records that show how their fees have been calculated. The Commerce Commission could then use its existing information-gathering powers to obtain these records.

Fees Option B: impose specific fee caps in regulation

101. This option would take a different approach to the current fee provisions.

102. Instead of restricting fees to costs, which vary widely between lenders and are difficult to calculate with certainty, this option would prescribe monetary fee caps for different types of mandatory fees, and prohibit other mandatory fees. Prepayment fees would continue to

be regulated as at present, and charges for optional services would continue to be unregulated.

103. Fee caps could vary according to the size of the loan, whether it is secured or unsecured, and whether the security interest is over real or personal property. For example, permitted fees for an unsecured, non-revolving consumer credit contract could include an establishment fee and default fee.

104. All other costs and profits would need to be recovered through interest rates, which would remain unregulated (except as provided by any interest and fee cap option adopted under Issue 1).

Types of lenders to which fee caps could apply

105. We would be interested in feedback on what kinds of lenders and fees could be subject to a fee cap, and where fee caps might be inappropriate. If Cap Option B or Cap Option C were pursued, depending on the structure of the interest and fee caps, high-cost lenders may already be covered by fee caps.

Setting maximum fees

106. A significant challenge for this option would be setting and updating the fee cap. This could be done through regulations or delegated to the Commerce Commission, and would be subject to statutory criteria.

16	If prescribed fee caps were introduced, who should they apply to, and what process and criteria should be used to set them?

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

107. Under this option, regulation of mandatory fees would be removed, and interest rates and fees would be bundled into an 'equivalent interest rate' for disclosure and advertising purposes. This would be similar to the 'annual finance rate' used prior to the CCCFA coming into force in 2004, and the annual percentage rate (APR) used in other jurisdictions such as the United States and the United Kingdom.

Costs and benefits of options for addressing unreasonable fees

108. Of these fee options, a requirement to substantiate the reasonableness of fees (Fees Option A) is the most straightforward and sits most comfortably with current fee regulation, but does the least to address unreasonable fees. It does not directly address issues with uncertainty, but aids enforcement – and so could provide greater certainty

over the long term as more case law develops. Fees Options B and C are both significant departures from the current treatment of fees.

Option	Pros	Cons
Fees Option A: require lenders to substantiate reasonableness of fees	• The prohibition on unreasonable fees would be easier to enforce, and more likely to be enforced. • Compliance with fees regulation likely to improve as non-compliant fees would be more likely to be detected.	• There may be a small increase in compliance costs for lenders with more careful documentation of fee-setting processes.
Fees Option B: impose specific fee caps in regulation	• Consumers would benefit from improved comparability of credit products. • Non-compliance with fees regulation would likely decrease. • Enforcement of fee caps would be straightforward for the regulator and consumers compared to existing law. • Consumers may, in the cases of very high fees, pay lower fees to borrow.	• Lenders may lose the ability to charge some fees that reflect their actual costs. This may see some fees rise up to the level of the cap. • Any reduction in fee revenue of lenders may simply be recouped by increasing interest rates and cross-subsidisation between borrowers.
Fees Option C: return to disclosure and advertising based on an 'equivalent interest rate'	• Would improve comparability of credit offerings by ensuring mandatory fees are taken into account by borrowers. • Compliance costs may decrease with no need to perform cost calculations to check reasonableness of fees.	• Involves significant transition costs for lenders due to the need to change all advertising and disclosure. • Disclosure of equivalent interest rates in a timely and accurate way is challenging especially when applying to revolving credit where the debt balance varies over time.

17	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
18	Do you have any suggestions for the design of options for reducing unreasonable fees? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
19	Which options for changes to fees regulation would you support? Which would you not support? Please explain how you made your assessment.

Potential for tightening regulation of third-party fees

109. We have heard concerns about parties such as brokers charging excessive fees, which are added to the loan. These fees may be unavoidable (or practically unavoidable) by the borrower where using the broker is a condition of obtaining finance, or the main route to obtaining finance.

110. Fees charged by a third party and payable from the proceeds of the loan are only "credit fees" if the third party is related to the creditor. For example, a finance broker who is unrelated to the creditor can have their fee added to the loan without it being a credit fee. The consequence of this is that there are no requirements for unrelated third-party fees to

be reasonable. Section 45 provides that the creditor may pass on the third-party fee without adding its own margin.

111. We would welcome further feedback on the extent of this issue, and whether further consideration needs to be given to the boundary between third-party fees that are credit fees and third-party fees that are not credit fees. One possibility would be to treat mandatory third-party fees as 'credit fees'. We would be interested in whether this would be practical – or, if not, how third-party fees could be limited.

20	Have you seen issues with excessive broker fees, or other unavoidable fees charged by third parties, being added to the loan? If so, are there any specific changes that should be made to the regulation of third-party fees? What would be the impact of these changes on lenders, borrowers and third parties?

Issue 5: Irresponsible debt collection practices

112. Debt collection for consumer credit contracts is currently regulated by the CCCFA. Despite this, we have heard concerns that debt collection practices frequently include false and misleading claims, harassment, excessive charges and unrealistic payment demands. Complaints to the Commerce Commission about debt collection have been steadily rising, from 23 in 2013 to 119 in 2017. It is likely that debt collection issues are under-reported.

113. In this discussion paper, the term 'debt collection' refers to all recovery action taken after a consumer defaults on a loan, beyond short-term steps taken to correct missed payments. This includes in-house debt collection (by the original creditor), a debt collection business acting as an agent of a creditor, or a debt collection business buying debt from lenders before pursuing it.

114. Problems with debt collection include:

    a. ***False and misleading claims:*** The majority of Fair Trading Act-related debt collection complaints received by the Commerce Commission pertain to misrepresentation of rights. The most common types of misleading and false claims being made by debt collectors relate to the right to collect debt (including non-existent debts, debts owed to a different person, or statute-barred debt) and the amount of the debt.

    b. ***Unaffordable repayment schedules:*** We have heard that it is common for debt collectors to make unaffordable repayment demands. In one example, a borrower offered the maximum of what they could afford to pay (approximately $120 per month in repayments); the debt collector refused and demanded that double that be paid.[10] Unaffordable repayment schedules create unnecessary additional stress and can cause or deepen hardship. We have also heard that, even where borrowers have defaulted due to difficulties in making regular payments, many debt collectors send initial letters to borrowers that demand immediate full and final payment of the debt.

    c. ***Excessive charges (fees and interest) for debt collection:*** We've been told that many debt collectors charge borrowers excessively high fees to collect loans. In some cases, total collection costs are bigger than the initial loan. Examples of individual fees include a $30 letter fee incurred when the debt is initially passed on to the debt collector and $15 being charged per phone call.

[10] Anonymised example provided by a consumer advocate.

d. ***Harassment:*** Stakeholders have raised concerns about harassment (sometimes unlawful) being used by some debt collectors as part of normal business practice. These include frequent phone calls to the borrower or their employer, and aggressive or coercive behaviour. We have heard that even after a repayment schedule is agreed, some debt collection agencies call borrowers frequently – whether or not the arrangement is being complied with – requesting them to either raise the repayment amount or repay the full outstanding amount immediately. More aggressive debt collection (and debt with higher rates of interest) is rewarded by being prioritised for repayment over other debt, which creates disincentives to collect debt responsibly (and an uneven playing field among debt collectors). Vulnerable consumers are highly unlikely to raise complaints with Police and use existing protections in criminal law.

115. The purpose of debt collection is to engage with borrowers and motivate repayment of debts. Some level of additional stress is inevitable for people who are reminded about their debts and asked to address them.

116. However, when taken together, the practices described above have the potential to create significant additional harm to consumers, particularly for vulnerable consumers.

117. Consumer advocates have observed these practices creating significant additional stress, which in turn contributes to a series of negative health and social consequences (including mental health problems, relationship issues, and family violence) for borrowers and their wider families.

21	Is this an accurate picture of the problems for consumers experiencing debt collection? Do you have information that confirms or refutes these issues, or sheds light on how widespread or severe they are?

Options to provide greater consumer protections for debt collection

118. We have set out five options for addressing potential harms caused by debt collection practices. These comprise increased disclosure requirements at commencement of debt collection, affordable repayment plans and limiting contact with the borrower and other persons. We are also considering options to make third-party debt collection agencies directly subject to the CCCFA and make external debt collection fees cost-based.

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

119. Under this option, creditors or assignee debt collectors would need to disclose the following information to the borrower before taking debt collection action:

a. the name of the original creditor, the date on which the debt was passed to the debt collector and a copy of the original credit contract and any agreed variations

b. a summary of the amount owing, and its composition – total advances, interest charged prior to debt collection, fees charged prior to debt collection, interest charged since debt collection and fees charged since debt collection

c. a continuing disclosure statement for the period since the last continuing disclosure statement

d. information about the rights of the borrower and contact information for budget advisory services.

120. We've heard that some debt collectors are already disclosing some of this information.

22	What information should be provided to borrowers by debt collectors? When and how should this information be provided?

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

121. This option would require debt collectors to, in any communication with a borrower in default, offer the borrower a new affordability assessment. If the borrower accepted the offer, either a new affordable repayment schedule would need to be determined or debt collection action would need to cease (other than official enforcement action such as repossession and court proceedings) and no further interest or fees could be charged.

122. A new repayment schedule would be prepared with the borrower, based on either the maximum amount affordable, or the repayments under the original contract, whichever is the lesser. Affordability would include consideration of borrowers' income and essential expenses. If a new repayment schedule is established, no payment demands could be made other than in accordance with the latest repayment schedule.

123. Consideration would need to be given to the time periods for various actions to occur, and how to ensure that the process is not abused.

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

124. Under this option, contact with borrowers would be limited to a specified appropriate frequency. We welcome feedback on what frequency is appropriate in different circumstances.

125. In addition, a borrower could request that the debt collector cease to contact them, and would also have the right to nominate a representative who the debt collector must

contact instead. All further contact with the borrower would then be prohibited, apart from a confirmation that contact will cease, and notices of official enforcement action such as repossession or filing of court proceedings. The borrower could cancel the request at any time. The debt collector could contact the borrower in respect of a new debt (subject to the same borrower right to cease contact).

126. The debt collector could also contact other persons, but only for the purpose of finding out the borrower's contact details. The debt collector would be prohibited from discussing the debt with any other person (consistent with existing rights under the Privacy Act 1993).

127. Breaches of these proposed requirements would be simpler for the Commerce Commission to enforce due to the specific nature of the protections. Civil pecuniary penalties and statutory damages would apply to breaches.

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

128. Debt collectors who have been assigned rights to the debt are creditors and directly subject to the CCCFA, but debt collectors acting as agents are not. Currently creditors are responsible for the actions of their agents. Debt collectors acting as agents have only indirect incentives to comply with the CCCFA – for example, if they contractually indemnify the creditor for their actions – and they do not need to be members of a dispute resolution scheme. This differs from the treatment of repossession agents: the CCCFA provides that court orders for compensation etc. can be made against repossession agents, and they also have a number of direct obligations under Part 3A.

129. Under this option, debt collectors who are agents of a creditor would be directly subject to a number of CCCFA requirements. This change would create stronger incentives for third-party debt collectors to comply with CCCFA, as they would be directly liable for breaches. In addition to any requirements taken forward from Debt Collection Options A–C, debt collection agents would need to comply with relevant lender responsibilities, register on the Financial Service Providers Register and become a member of a dispute resolution scheme.

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

130. Some credit contracts include a general clause in which the borrower in default agrees to pay any costs incurred by the creditor in attempting to recover amounts owing. This allows third-party debt collectors to charge high fees to the borrower, and creditors currently have weak incentives to limit these. The CCCFA provides that "default fees" must be reasonable, but it is unclear how this applies to fees charged by an external debt collector.

131. Under this option, only the actual costs incurred by debt collectors acting as agents of creditors could be passed on to borrowers and these would also be subject to any changes

proposed to fees under Issue 4. Any additional fees or commissions charged by the debt collector would need to be paid by the creditor.

Costs and benefits of options for debt collection

Option	Benefits	Costs
Debt Collection Option A: increase disclosure requirements at commencement of debt collection	• Would improve self-enforcement by improving transparency of processes. • Could reduce false and misleading claims, as debt collectors have to provide evidence and information about rights from the outset.	• Creditors and debt collectors are likely to incur compliance costs in preparing these initial disclosures.
Debt Collection Option B: require debt collectors to offer an affordable repayment plan	• Reduces issues around debt collectors demanding unaffordable repayments. • Would reduce the incentives to provide borrowers with unaffordable loans as they would be more likely to be written down.	• Creditors and debt collectors would incur significant upfront compliance costs as they invest in new processes. • The new processes are likely to reduce recovery rates and this may cause cross-subsidisation and higher interest rates or loan fees. • The new processes and requirements would require higher ongoing enforcement and monitoring costs.
Debt Collection Option C: specify appropriate limits regarding contact between the debt collector, borrower and other persons	• Would be likely to reduce harassment of borrowers by debt collectors.	• The new processes are likely to reduce recovery rates and this may cause the cost of default to be cross-subsidised by increasing interest rates.
Debt Collection Option D: make third-party debt collection agencies directly subject to the CCCFA	• Would create stronger incentives for debt collection agents to comply with the CCCFA and greater consistency across the industry. • Enforcement options and access to redress would become more straightforward with third-party agents covered by dispute resolution schemes. • Overseas debt collectors registering on the FSPR will enable greater oversight and make enforcement action easier.	• Compliance requirements for third-party agents would increase.
Debt Collection Option E: make external debt collection fees cost-based	• Would reduce problems with borrowers being charged excessive debt collection charges.	• Would increase compliance costs on debt collectors acting as agents for creditors. • Creditors may pass on the greater compliance costs of debt collection to borrowers in the form of higher interest rates.

132. All options could be adopted together, or a selection of options could be adopted. Adopting all the options will place a significant compliance burden on debt collectors, whereas adopting fewer options may not effectively protect consumers. We welcome feedback from debt collectors on the impacts of each of these options, and the impacts of pursuing multiple options on business models.

23	Do you agree with our assessment of the costs and benefits of the options for addressing irresponsible debt collection? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
24	Do you have any suggestions for the design of options for addressing irresponsible debt collection? In particular, what is an appropriate frequency of contact with debtors before (and then after) a payment arrangement is entered into? Please state the likely impact of your proposed options on borrowers, lenders and the credit market.
25	Which options for changes to the regulation of debt collection would you support? Which would you not support? Please explain how you made your assessment.

Other issues

Small business loans, investment loans and family trusts

133. Small business loans, investment loans and family trusts are excluded from the protections of the CCCFA (unless a consumer good such as a personal vehicle is used as security).

134. Businesses, investors and trustees may be expected to have a greater level of financial literacy than most consumers and are expected to obtain legal advice. However, this may not always be the case, particularly for small businesses, retail investors and non-professional trustees. We have been referred to examples of situations where retail investors have, or could be, harmed by borrowing to invest, such as highly leveraged investors in Australian agribusiness schemes and people offered finance for foreign exchange transactions (other than financial derivatives).

135. We are interested in your views on whether the principle of excluding small businesses, investment loans (for retail investors) and family trusts from the consumer protections under the CCCFA is the right policy in general. We have only heard about these issues from a small number of stakeholders. As such, we have not proposed a change in this discussion document because it would significantly broaden the scope of the CCCFA.

26	Are you seeing harm from loans to small businesses, retail investors or family trusts as a result of them not being regulated under the CCCFA?
27	Do you think small businesses, retail investors or family trusts should have the same or similar protections to consumers under the CCCFA? Please explain why/why not.

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

Recap of questions

1	Do you agree that the problems identified with high-cost lending (even where it is compliant with the CCCFA) are significant? Do you have any information or data that sheds light on their frequency and severity?
2	Do you support any of the extensions of Cap Option A? What would be the impact of these extensions on borrowers, lenders and the credit markets? Do you have any information or data that would support an assessment of the impact of these extensions?
3	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
4	Do you have any suggestions for the design of options for capping interest and fees? If so, what would be the impact of your proposed design on borrowers, lenders and the credit markets?
5	Which interest rate cap options, if any, would you prefer? Which interest rate options would you not support? Please explain how you made your assessment.
6	If directors have duties to take reasonable steps to ensure that the creditor complies with its’ CCCFA obligations, should any duties apply to senior managers?
7	If there are to be more prescriptive requirements for conducting affordability assessments, what types of lenders or loans should these apply to?
8	Should there be any change to the requirement that lenders can rely on information provided by the borrower unless the lender has reasonable grounds to believe the information is not reliable? What would be the impact of such a change on borrowers, lenders and the credit markets?
9	Do you consider there should be any changes to the current advertising requirements in the Responsible Lending Code? If so, what would be the impact of those changes on borrowers, lenders and the credit markets?
10	Do you agree with our assessment of the costs and benefits of the options to reduce irresponsible lending and other non-compliance? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?

11	Do you have any suggestions for the design of options for reducing irresponsible lending and other non-compliance? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
12	Which options for reducing irresponsible lending and other non-compliance would you support? Which would you not support? Please explain how you made your assessment.
13	Do you agree with our assessment of the costs and benefits of the options for covering additional credit contracts under the CCCFA? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
14	Do you have any suggestions for the design of options for covering additional credit contracts under the CCCFA? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
15	Which options for changes to cover additional credit contracts would you support? Which would you not support? Please explain how you made your assessment.
16	If prescribed fee caps were introduced, who should they apply to, and what process and criteria should be used to set them?
17	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
18	Do you have any suggestions for the design of options for reducing unreasonable fees? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
19	Which options for changes to fees regulation would you support? Which would you not support? Please explain how you made your assessment.
20	Have you seen issues with excessive broker fees, or other unavoidable fees charged by third parties, being added to the loan? If so, are there any specific changes that should be made to the regulation of third-party fees? What would be the impact of these changes on lenders, borrowers and third parties?
21	Is this an accurate picture of the problems for consumers experiencing debt collection? Do you have information that confirms or refutes these issues, or sheds light on how widespread or severe they are?
22	What information should be provided to borrowers by debt collectors? When and how should this information be provided?

23	Do you agree with our assessment of the costs and benefits of the options for addressing irresponsible debt collection? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
24	Do you have any suggestions for the design of options for addressing irresponsible debt collection? In particular, what is an appropriate frequency of contact with debtors before (and then after) a payment arrangement is entered into? Please state the likely impact of your proposed options on borrowers, lenders and the credit market.
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28	Are there any other issues with the CCCFA or its impact on vulnerable people that are not addressed in this discussion paper? If so, what options should MBIE consider to address these issues?