

The Chair

Cabinet Business Committee

Responsible Lending Requirements for Consumer Credit Providers

Proposal

1. This paper proposes strengthening the Credit Contracts and Consumer Finance Act 2003 to ensure credit providers lend and manage credit contracts responsibly. This is a revised paper following discussion at Cabinet Economic Growth and Infrastructure Committee (EGI) of EGI (11) 223 [EGI Min (11) 22/3 refers]. The Minister of Consumer Affairs was invited to give further consideration to the proposals in EGI (11) 223 and to submit a revised paper to Cabinet Business Committee on 25 October 2011 which:
 - includes further advice on whether taking more enforcement action in respect of those credit providers who are not registered as required under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 would be sufficient to address irresponsible lending issues;
 - takes a broader approach to the proposed Responsible Lending Code.

Executive Summary

2. Over the last 4 years there has been a significant overhaul of the rules and regulations that govern the financial sector, designed to improve the conduct and practices of the industry. The overhaul has focussed on the investment side of the sector and includes establishing the Financial Markets Authority (FMA) and requiring those who give financial advice and sell financial products to meet professional conduct standards.
3. The financial sector reforms included the requirement that from 1 December 2010 consumer credit providers must be registered¹ and belong to a dispute resolution service. A review of third-tier providers in April 2011 identified about 35% were not registered or registration was not by the trading name of the provider. Following contact, there remain about 10% of third-tier providers who are in discussion with the FMA about whether they should be registered (mainly pawnbrokers).
4. Registration provides basic negative assurances about the person running the business². However, for credit providers there are no regulated conduct obligations equivalent to those applying to financial advisors when dealing with consumers, for example, to exercise the care, diligence and skill of a responsible practitioner.
5. The Credit Contracts and Consumer Finance Act (CCCFA), which is the main law applying to credit providers, is focussed on promoting competition amongst credit suppliers and enabling consumers to make informed decisions. These goals are delivered through requiring disclosure of interest rates and terms and conditions.

¹ Under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

² They are not disqualified because they are a banned director, undischarged bankrupt or convicted of specified Crimes Act or money laundering offences.

6. The CCCFA also includes provisions that protect consumers when in unforeseen hardship, and against oppressive contracts and unreasonable fees. However, there is a gap in the regime regarding requirements that credit providers behave responsibly.
7. This law is not providing adequate consumer protections against unscrupulous third-tier lenders (loan sharks, fringe providers) whose irresponsible lending practices are resulting in severe financial hardship and spiralling debt. The problems are:
 - Lenders who operate a business model where consumers get access to credit ‘no questions asked’ and credit contracts are framed to disguise the full cost of the credit and the severe cost if the borrower does not meet repayment obligations.
 - Lenders who have a business model that benefits from taking advantage of a consumer’s vulnerability, such as a lack of sophistication when dealing with credit providers, the need for credit urgently and English as a second language.
 - Insufficient differentiation between the oppression test for business credit contracts and consumer credit contracts. The Courts apply the reasonable standards of commercial practice for business contracts to consumer contracts. The result is the oppressive contract provisions do not provide effective protections for consumers.
8. Addressing these problems requires a package of initiatives based around adding to the CCCFA a responsible lending purpose and principles along the lines that exercising the care, diligence and skill of a responsible lender includes:
 - Credit offered must be reasonably expected to meet the needs or purposes of the borrower (similar language to Consumer Guarantees Act services guarantee),
 - The borrower must be reasonably expected to repay the loan without substantial hardship, and
 - The lender must be honest and transparent in dealing with the borrower.
9. Adding responsible lending to the CCCFA will mean consumer credit law has a more holistic approach consistent with other financial sector reforms. It is not desirable to have artificial boundaries between the regulation of investment and credit products and providers. There was strong support for adding a responsible lending framework to the CCCFA at the Financial Summit held in August 2011, in Auckland.
10. The framework for responsible lending that is proposed is as follows:
 - A responsible lending purpose and principles as above.
 - A Code of Responsible Lending which will be determined in consultation with lenders and other stakeholders, based on existing best practice and international models.
 - Provide the regulator may impose conditions on a provider’s registration if after formal warning a lender has not complied with the Code of Responsible Lending.
 - Provide registration may be cancelled for not lending responsibly in accordance with the Code of Responsible Lending or the Credit (Repossession) Act 1997.
 - Improved disclosure requirements including -
 - Disclosure of key information, and full terms and conditions of the consumer credit arrangements must occur before the contract is made (present requirement allows for disclosure up to 5 working days after the contract is made).
 - Standard contract terms and key information must be on lender’s website.
 - Advice on dispute resolution and hardship provisions added to key information.
 - Require the contract must specify goods over which security for a loan is taken.

- Provide a 5 working-day cooling-off period following the making of a consumer credit contract (currently 3 working days).
 - Provide borrower is excused from liability for the costs of borrowing under a consumer credit contract if the lender is an unregistered financial service provider (i.e. the consumer only has an obligation to repay the amount of the loan less any fees paid, and no interest up to the time of registration).
 - Add to the oppressive credit contract provisions specific tests for consumer credit contracts separate from business credit contracts.
 - Allow hardship applications if in default for less than 2 months, require lenders to process applications in defined times and provide reasons why an application is declined, and preclude hardship application and default fees.
 - Provide that goods protected on bankruptcy under the Insolvency Act 2006 are also protected from secured creditors (e.g. tools of trade, necessary household furniture and effects and a motor vehicle up to the value of \$5,000), except if the credit contract is for the purchase of such an item.
11. It is not proposed to introduce credit provider or lender licensing. The proposal that a borrower is excused from liability for the costs of borrowing under a consumer credit contract if the lender is an unregistered financial service provider will strengthen the existing requirement to be registered and comply with the CCCFA.
12. The Commerce Commission is currently responsible for monitoring and enforcement of the CCCFA. The FMA has been established as the key regulator of the financial sector. It is proposed consideration is given to the FMA having responsibility for monitoring and enforcement of credit regulation and the exercise of powers under the Credit (Repossession) Act.
13. The package of amendments to the CCCFA and putting in place the Code of Responsible Lending will provide the regulator with more tools to stop lenders whose business model deliberately takes advantage of consumers who are unsophisticated and vulnerable. Whilst the Commerce Commission and the FMA have been able to take some enforcement action, this has been hampered by the lack of clear provisions in the CCCFA regarding responsible lending and charging of fees and only having basic negative assurance registration rather than specific conduct provisions.
14. The package of initiatives does not include any proposals on cost of finance caps at this stage. The Ministry of Consumer Affairs is progressing work on cost of finance caps that includes monitoring the progress of Australian Commonwealth cost of finance caps legislation and evaluating the impact any cost of finance cap in New Zealand.

Background

15. In recent years there has been a wide ranging programme of reform of financial sector legislation, including:
- The new regulatory regime for financial service providers enacted in 2008 through the Financial Advisers Act and Financial Services Providers (Registration and Dispute Resolution) Act 2008;
 - Prudential regulation of non-bank deposit takers enacted in 2008 through Part 5D of the Reserve Bank of New Zealand Act 1989, a licensing regime for deposit-takers which is set out in the Non-Bank Deposit Takers Bill 2011; and disclosure rules for non-bank deposit takers currently being finalised;
 - Prudential regulation of the insurance sector enacted under the Insurance (Prudential Supervision) Act 2010;

- A new licensing regime for securities trustees and statutory supervisors that is being established under the Securities Trustees and Statutory Supervisors Act 2011;
 - The establishment of a new consolidated market conduct regulator for the financial sector, the Financial Markets Authority (FMA);
 - Measures to strengthen the governance of and disclosure by KiwiSaver schemes; and
 - The Securities Act Review, which is being progressed through the Financial Markets Conduct Bill.
16. The financial sector reforms have focussed on the investment-side of the sector.³ The thrust of the financial sector reforms outlined above has concerned improving the quality of services provided to consumers and improving the regulatory settings to give consumers confidence to deal in capital markets. It seems appropriate that similar objectives are used for the credit side.⁴
17. An operational review of the Credit Contracts and Consumer Finance Act 2003 (CCCFA) was initiated in 2007 to assess how the Act was meeting its objectives five years after coming into effect. A discussion paper on this review was released in September 2009 which outlined some proposed changes to improve the operation of the CCCFA and the Credit (Repossession) Act 1997 [EGI Min (09) 20/11 and CAB Min (09) 34/6 refer]. Fifty nine submissions were received on the discussion paper.
18. This review did not consider whether consumer credit laws needed to be improved in a similar manner to the reforms being progressed for the rest of the financial sector in order to better protect consumers and meet international commitments and standards. The existing consumer credit law is focussed on individual decision-making and the promotion of competition, with some consumer protections. There is a gap in the regime regarding any requirements that credit providers behave responsibly.
19. There are many credit providers which are transparent, responsible and open. Unfortunately, there are credit providers which are not and that take advantage of consumer vulnerabilities, such as a lack of sophistication when seeking credit and committing to credit contracts, the need for credit urgently, and English as a second language. Lenders provide credit to some consumers 'no questions asked', disguise its high cost, and back up debt collection with threats and seizing essential household items.
20. Attempts to address issues in this area have included two Private Members' Bills that have been presented to Parliament in the last two years: Carol Beaumont's Credit Reforms (Responsible Lending) Bill (defeated at First Reading in 2010); and Sam Lotu-liga's Moneylenders (Licensing and Regulation) Bill.
21. In August 2011, a Financial Summit hosted by the Minister of Consumer Affairs and chaired by Sir John Anderson was attended by about 250 representatives of community agencies, credit providers, industry associations, dispute resolution service providers and government agencies. Objectives of the Summit included: an agreed action plan with initiatives for addressing problem consumer debt; and promotion of responsible lending and debt management.

³ The Financial Service Providers (Registration and Dispute Resolution) Act 2008 affects credit providers who must be registered and provide their retail clients with access to dispute resolution.

⁴ The review of Financial Products and Providers that preceded the financial sector reforms had four objectives: a sound and efficient financial system; investment which encourages growth and innovation; an environment which facilitates wealth accumulation; and confidence in the sector which encourages participation by consumers and market participants.

22. The Summit participants considered both regulatory and non-regulatory options. There was considerable consensus at the Summit on initiatives that should be progressed, with a strong mandate supporting regulation of responsible lending, improved disclosure, responsible debt management practices and enforcement of registration requirements.

Comment

23. Irresponsible lending and problem debt are not issues that can be addressed by one or two amendments to the CCCFA. Rather, they require a package of initiatives based on adding a new purpose to the CCCFA along the lines of promoting the responsible provision and management of consumer credit contracts and consumer leases. Adding a responsible lending purpose to the CCCFA would mean that credit law has a more holistic approach consistent with other financial sector reforms. The framework for consumer credit law would then be:

Responsible lending – before entering into and throughout the management of a contract or lease	Information disclosure – to allow consumers to make more informed decisions	Promotion of competition – through disclosure that allows comparison of offerings	Consumer protection – especially from unreasonable, harsh and oppressive behaviour
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Addition of responsible lending purpose and principles to the CCCFA

24. Credit providers (lenders) are required to be registered and must belong to a dispute resolution scheme. They must meet the disclosure and fees requirements in the CCCFA. The Fair Trading Act 1986 generally prohibits misleading and deceptive conduct and unfair practices; and there is the general guarantee in the Consumer Guarantees Act 1993 that where services are supplied to a consumer they will be carried out with reasonable care and skill. There is, however, no specific legal obligation that credit providers must take into account the ability of the client to repay any loan and whether the client understands the terms and conditions of the loan.

25. The reason for not having any specific legal obligation is likely based on the premise that defaulted loans or bad loans are a cost to business and the expectation is that businesses seek to avoid them. A credit provider as part of sound business practice should make an assessment of a client's needs and ability to repay the loan and make sure a client understands repayment requirements. However, less scrupulous lenders would appear to have established their business model on the likelihood of consumers being unable to complete the terms of their loan and then charging the consumer high default fees and default interest. This model means that ensuring loans are repaid according to their terms is less vital and may in fact be counter to the lenders' interests. Lenders which appear to use this business model are undertaking irresponsible lending causing problem debt issues.

26. In contrast to credit providers, financial advisers⁵ must be registered and have specific conduct and competence requirements under the Financial Advisers Act including that when providing financial adviser services to retail clients (consumers) they must:

- act with care, diligence and skill,
- not engage in misleading or deceptive conduct, and
- comply with disclosure obligations when providing personalised services.

27. An authorisation system for credit providers could be developed similar to that for financial advisers but this would add a layer of compliance licensing on those credit

⁵ Some credit providers may be authorised financial advisers or QFEs but the majority are not.

providers also providing financial advice and under prudential supervision from the Reserve Bank (and more likely to be lending responsibly). The proposed alternative is:

- Adding to the CCCFA responsible lending as a purpose and that lenders are required to exercise the care, diligence and skill⁶ of a responsible lender including -
 - Credit offered must be reasonably expected to meet the needs or purposes of the borrower (similar language to Consumer Guarantees Act services guarantee),
 - The borrower must be reasonably expected to repay the loan without substantial hardship,
 - The lender must be honest and transparent in dealing with the borrower,
- Setting out the types of practices recognised as meeting the responsible lending principles above in a Code of Responsible Lending, and
- Providing for the monitoring and enforcement of compliance with the Code by the regulator.

28. It is proposed a person not lending responsibly in accordance with the Code of Responsible Lending or the requirements of the Credit (Repossession) Act is grounds for the regulator to seek a court order that the person may be prohibited from providing credit contracts or leases. This is one of the existing grounds for disqualification from registration in the Financial Service Providers (Registration and Dispute Resolution) Act. It is also proposed to enhance the CCCFA regime to allow the regulator to impose conditions on the registration of a credit provider if a formal warning given by the regulator to a provider which may not be complying with the Code of Responsible Lending or the requirements of the Credit (Repossession) Act has not been heeded. This approach would promote responsible lending without the need for a new licensing or authorisation regime and the associated compliance costs.

Code of Responsible Lending

29. Regulation making powers are proposed for a Code of Responsible Lending for credit providers along similar lines to the Code of Professional Conduct for Authorised Financial Advisers under the Financial Advisers Act. The Code would set out the types of practices accepted as meeting the responsible lending principles. These will be determined in consultation with lenders and other stakeholders, based on existing best practice and international models and are likely to include:

- Lender must assess that the loan can reasonably be expected to be repaid without substantial hardship.
- Credit advertising must not mislead or confuse.
- Key terms must be disclosed before making the contract.
- Terms of the contract must be fair, balanced, clear and intelligible.
- Goods secured must be specified, and may not include the essential household items excluded from bankruptcy under the Insolvency Act

30. Australia and the United Kingdom Guidelines for responsible lending and the Financial Services Federation's voluntary Responsible Lending Guidelines⁷ will be used in preparing the Code.

⁶ These match a similar duty on financial advisers to act with care, diligence and skill.

⁷ The Financial Services Federation's Responsible Lending Guidelines broadly cover the topics noted in paragraph 30 but they do not have the force of law and do not have full market coverage.

Contracts with Unregistered Providers

31. Desk-top research carried out by the Ministry of Consumer Affairs in April 2011 estimated about 35% of third-tier lenders may not be registered as required. Unregistered lenders are likely to be less scrupulous in their dealings towards borrowers, and less concerned about complying with other laws such as the CCCFA. Non-registration means that borrowers from those credit providers do not have access to a dispute resolution scheme.
32. Following contact by the FMA with third-tier providers identified as not or incorrectly registered, one third have now registered or are in the process of registering (or have exited the market) and another third have been identified as not having their trading name correctly stated on the register (which has now been corrected). The FMA is in discussion with the remaining third (representing about 10% of all third-tier providers).
33. Financial Summit participants indicated strong concern about third-tier lenders which may be operating outside of the law, and suggested voiding of contracts as a strong incentive to encourage registration as well as a way of obtaining relief for consumers directly affected by the contracts and the lack of access to dispute resolution.
34. Voiding contracts would not be straightforward and could cause more problems for an affected borrower. It is proposed instead of voiding contracts, that the CCCFA is amended to provide that borrowers will be relieved from paying the costs of borrowing (interest, fees and penalties) where a contract is with an unregistered credit provider, and that borrowers will be relieved up until the credit provider is registered. This approach will provide credit providers with an incentive to register whilst leaving the underlying loan to the borrower in place. It is a more proportionate response to non-registration than voiding the entire contract.
35. Registration provides basic negative assurances about the person running the business⁸. However, it does not protect against the lending practices the responsible lending package will address. It is complementary to rather than a substitute for the responsible lending initiatives.

Responsible Advertising

36. Research by the Ministry of Consumer Affairs⁹ and Colmar Brunton¹⁰ has clearly established that a considerable amount of credit advertising by third-tier lenders is irresponsible. This advertising is highly influential on vulnerable, low socio-economic consumers and is a major factor in some consumers' choice of credit provider. As a result, consumers may enter inappropriate and unaffordable credit contracts.
37. The Financial Advisers Act requires that advertising by financial advisers must not be misleading, deceptive, or confusing. It is proposed the CCCFA is amended to include a similar requirement that credit advertising must not be misleading, deceptive or confusing and must comply with any requirements of the Responsible Lending Code. The regulator also has powers to prohibit advertisements if they are misleading and to give directions to financial advisers if they fail to comply with the advertising requirements of the Financial Advisers Act. It is proposed that there is a similar power added to the CCCFA for the

⁸ They are not disqualified because they are a banned director, undischarged bankrupt or convicted of specified Crimes Act or money laundering offences as provided under section 14 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

⁹ The Ministry of Consumer Affairs, Third-tier Lender Desk-based Survey 2011. Wellington: Ministry of Consumer Affairs, 2011.

¹⁰ Colmar Brunton for the Ministry of Consumer Affairs. Using a third tier lender: experiences of New Zealand borrowers. Wellington: Ministry of Consumer Affairs, 2011.

regulator to intervene and prohibit credit advertisements. This power will enable swift action to be taken to prevent consumers being disadvantaged.

38. It is also proposed credit advertising contain the registration number and name by which the lender is registered to promote transparency and registration, and facilitate complaints about irresponsible advertising. This was recommended at the Financial Summit.

Disclosure

39. The CCCFA disclosure provisions are not meeting the objectives to allow consumers to make more informed decisions and to allow comparison of offerings, especially regarding third-tier providers. Particular concerns are:

- lack of up-front disclosure¹¹ and disclosure which is complicated and unclear, for example the statement of the right to cancel,
- non-disclosure of some contract variations (a cause of unnecessary disputes which are difficult to resolve),
- standard terms and conditions not being available for consumers to read in advance,
- lack of information on dispute resolution services and financial hardship provisions.

40. Colmar Brunton's research reviewed 24 users of third-tier lenders and found only 19 (79%) appeared to have been given at least basic information about their loan details, and 9 (47%) of those users came away with a limited understanding of the loan terms and conditions. A key theme at the Financial Summit was the need for up-front disclosure of simpler and more meaningful key information. Improved disclosure, addressing the above gaps, will allow consumers to make more informed decisions and comparisons of products as well as improve knowledge of consumer protections available.

41. Good disclosure is an essential element of responsible lending. There should be testing of disclosure requirements to make sure they are effective and in clear, plain English. The Ministry of Consumer Affairs is working on effective disclosure documents which will be prescribed in regulations. Good disclosure also includes clear information about any goods over which security is taken. Responsible lending should provide that essential household items and tools of trade should be protected from repossession, in the same manner as such goods are protected on bankruptcy.

42. Accordingly, it is proposed that the CCCFA is amended:

- To require the full contract, key information, and terms of any credit-related insurance products or extended warranty arranged by the lender are disclosed up-front.
- To include in the key information advice about access to dispute resolution and the hardship provisions.
- To require that any goods over which security is taken must be specified in the contract, and the goods that are protected on bankruptcy under the Insolvency Act 2006 are also protected from secured creditors (e.g. and tools of trade, necessary household furniture and effects and a motor vehicle up to the value of \$5,000), except if the credit contract is for the purchase of the item.

¹¹ The CCCFA requires disclosure of key information about credit arrangements within 5 working days after a credit contract is signed, as well as the terms of the contract; and the terms of credit-related insurance products a lender has arranged for a consumer within 15 working days.

- To provide for the standard terms and conditions of a lender's credit contracts to be available on the lender's website, or on request by a consumer.
- To require the particulars of all credit arrangement variations (even if they reduce a debtor's obligations) to be provided to the debtor in writing.
- To provide that the form and content of disclosure requirements may be prescribed.
- To delete the detailed "statement of the right to cancel" in the CCCFA (which will be replaced by a plain English statement in new disclosure regulations).

Cooling-Off Period

43. Under the CCCFA, a consumer has the right to cancel a credit contract within 3 working days of receiving disclosure from the lender. The cooling-off period recognises that there can be some pressure selling associated with credit products. The Consumer Law Reform Bill provides for a 5 working-day cooling-off period for extended warranties and uninvited direct selling. It is proposed the CCCFA also has a 5 working-day cooling-off period.

Fees

44. The CCCFA provides that fees under consumer credit contracts may not be 'unreasonable', and sets out the factors for determining whether particular types of fees are unreasonable. The general principle is that credit fees charged above interest should reflect the reasonable and actual costs of the lender that are additional to the general costs of business. The application of the principle under the current provisions has been uncertain.

45. The proposals relating to responsible lending and improved disclosure are relevant to the reasonable fee protection in the CCCFA. The obligation not to charge unreasonable credit fees aligns with the proposed new CCCFA purpose and principles to lend responsibly, and the Code of Responsible Lending could include specific provisions regarding charging reasonable fees. Credit fees will also be required to be disclosed under the new disclosure regulations. To further assist fees clarity, it is proposed the current fees provisions in sections 41 – 45 of the CCCFA are redrafted to clarify that fees charged reflect the reasonable and actual costs of the lender that are additional to the general costs of business.

Hardship

46. The CCCFA provides that consumers may request a change to their contract terms on the grounds of unforeseen hardship (such as an illness, injury, or loss of employment) if they are not in default or over their credit limit. Contract changes under the hardship provisions do not reduce the consumers overall debt obligation, but they provide the benefit of having reasonable changes to repayments¹² as an alternative to getting into further financial difficulty or facing penalties such as asset repossession. The hardship provisions are a key aspect of responsible debt management.

47. Research¹³ indicates that many hundreds of people who seek advice on debt issues every quarter could benefit from more accessible hardship provisions. Many people do not seek help with their debt until they are in default. There is also a problem with applications not being assessed in a timely manner and the consumer then getting into

¹² The consumer can request an extension of the contract term (with a reduction in amount of each payment) and/or a postponement of the dates on which payments are due.

¹³ Based on 2009 information from two Auckland based Citizens Advice Bureaux and Families Commission research.

default and being charged default fees/interest. In addition, lenders can charge a hardship application fee and add default fees to a consumer's debt at a time of financial hardship, which are counterproductive to the hardship provisions.

48. It is proposed that the CCCFA be amended to place more responsibility on lenders by setting time limits for acknowledging and processing hardship applications, preventing lenders from having application fees/eligibility tests, and providing consumers with the reason/s for any declined application. It is also proposed that the provisions are extended to allow applications from consumers that have been in default¹⁴ for less than 2 months, and to preclude the charging of default fees/interest while a hardship application is being considered.

Oppressive Contracts

49. The protections for consumers in the CCCFA include the ability for borrowers or the regulator to apply to the Courts for oppressive credit contracts to be re-opened and modified. The oppression remedy in the CCCFA seems to be very broad, but there is no evidence that the oppression remedy has been providing effective protection from unscrupulous creditors.
50. The emphasis in the current test for oppressive credit contracts on the reasonable standards of commercial practice is failing to provide protection for consumers against harsh or exploitative lending practices by some creditors. It is proposed the test is modified by replacing or supplementing the reference to reasonable standards of commercial practice with a reference to responsible lending obligations in relation to consumer credit contracts, and to modify the current guidelines in section 124 of the CCCFA to add specific consumer protection factors for consumer credit contracts. It is also proposed that the Court is required to have regard to whether the enforcement or recovery actions taken by a creditor are proportionate to the amount of the default or the debt, so disproportionate enforcement or recovery actions would be oppressive.
51. There is also a problem with the enforcement of the oppressive credit contracts remedy. The regulator has the legal ability to apply to the Court on behalf of a person or class of persons to re-open oppressive credit contracts, but it has not done so. In practice, the remedy exclusively relies on self-enforcement by borrowers taking claims to the Disputes Tribunal or other Courts.
52. It is proposed that the regulator be given the power to apply to the Court for an order re-opening all or any of a class of consumer credit contracts that are oppressive whenever they are used by the creditor. This remedy is available to the regulator in Australia.
53. These amendments would mean the Courts would be more likely to exercise the discretion to re-open exploitative or predatory consumer credit contracts which are not currently regarded as being oppressive under the CCCFA. The increased scope and the ability to take more general enforcement actions would also increase the incentive for the regulator to take those actions in appropriate cases.

Monitoring and Enforcement

54. Currently, the Commerce Commission is responsible for monitoring and enforcement of the CCCFA.
55. At the time of establishing the FMA consideration was given to including regulatory responsibility for the CCCFA as one of its market regulation functions. However, no clear

¹⁴ Or over their credit limit

reason was seen to separate enforcement of the CCCFA from Fair Trading Act enforcement, where there are some synergies. The proposal to add responsible lending requirements to the CCCFA and to align its consumer protections with other financial sector reforms, lends support to the FMA being the CCCFA regulator. This aligns with the 'twin peaks' model that consolidates financial sector market regulation in one place¹⁵.

56. The Committee's agreement in principle is sought to further investigation of the FMA being the regulator responsible for monitoring and enforcement of the CCCFA and monitoring of credit repossession practices under the Credit (Repossession) Act 1997. I have asked the Ministry of Consumer Affairs to work with the Treasury, the Ministry of Economic Development, the Commerce Commission and the FMA on investigating this proposal. This work needs to consider the financial implications, law changes needed, timing and transitional arrangements to enable the smooth transfer of the monitoring and enforcement responsibility of the CCCFA from the Commerce Commission to the FMA if this course of action seems most appropriate. The Ministry will report to the Committee by 31 March 2012. One important issue to resolve is regulatory responsibility when enforcement intersects both financial sector legislation and the Fair Trading Act.
57. Any transfer of responsibility from the Commerce Commission to the FMA will not occur until after the amendments to the CCCFA have been made. Consideration will be given to aligning the timing to when the FMA takes responsibility for matters covered by the Financial Markets Conduct Bill.

Cost of Finance Caps

58. Interest rate caps or cost of finance (interest and fees) caps are often put forward as a way of protecting consumers from paying very high prices to access credit. This is a complex area. Cost of finance caps are difficult to design in a way which ensures that they cannot be circumvented by credit providers and do not create unintended consequences. This is demonstrated by the lack of international convergence on cost of finance caps.
59. The Australian Commonwealth has recently completed an evaluation of cost of finance caps. The Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 introduced to the Commonwealth House of Representatives in September 2011 provides for a national cost of finance cap of 48% with a separate cost of finance regime for short-term small-amount loans (these loans would have a 10% establishment fee cap and a monthly cap of 2% per month).
60. The responsible lending package of initiatives proposed in this paper does not include cost of finance caps at this stage. The Ministry of Consumer Affairs is progressing work on cost of finance caps that includes monitoring the progress of Australian Commonwealth cost of finance caps legislation and evaluating the impact any cost of finance cap in New Zealand.

Risk

61. The package of initiatives proposed is designed to achieve the outcome of responsible lending. There is a risk that some lenders will exit the market and some potential borrowers may not be able to readily access credit. At the extreme, this could result in consumers accessing 'underground' credit sources. The proposal to provide that borrowers will be relieved from paying the costs of borrowing (interest, fees and penalties) from unregistered credit providers, up and until the credit provider is registered,

¹⁵ The FMA currently oversees and administers the Securities Act 1978, the Securities Markets Act 1988, the Financial Advisers Act 2008 and a range of other financial service provider laws.

will go some way towards mitigating this risk. This proposal is a significant disincentive to providing credit by unregistered lenders as essentially the credit may be provided at no cost to the consumer.

Consultation

62. In August 2011, a Financial Summit was held in Auckland attended by about 250 representatives of community agencies, credit providers, industry associations, dispute resolution service providers and government agencies to discuss problem debt and responsible lending initiatives. There was specific consideration of some issues such as amending the CCCFA hardship and disclosure provisions. Fifteen submissions were also received following the Summit discussing possible responsible lending initiatives.
63. In September 2009, the discussion document 'Review of the Operation of the Credit Contracts and Consumer Finance Act' was released. Fifty nine submissions were received from a range of consumer representatives, government agencies and finance providers.
64. There has been consultation on specific matters through research commissioned by the Ministry of Consumer Affairs and undertaken by Colmar Brunton in July 2011 on the experience of borrowers who had used third tier lenders.
65. There has been consultation with the Law Commission which is reviewing the Credit (Repossession) Act. The Ministry of Consumer Affairs during consumer and community training days in 2009-2011 has had discussion on possible amendments to the CCCFA. There has also been liaison with Australian government officials in respect of the Australian credit law and cost of finance.
66. The Treasury, Ministry of Economic Development, Department of Prime Minister and Cabinet, Commerce Commission, Financial Markets Authority (FMA), Ministry of Social Development, Department of Labour, Te Puni Kokiri, Families Commission and OEGI were consulted on EGI (11) 223 and consulted or informed about this paper.

Treasury Comment

67. As noted in the paper, there are potential risks regarding access to credit. Treasury is concerned that these changes could force borrowers at the lower end of the market into underground (black market) credit sources, which would undermine the purpose of the changes. Given this, we support the release of an Exposure Draft Bill, as recommended by the paper.

Fiscal Implications

68. There are fiscal implications depending on whether the FMA or the Commerce Commission is responsible for the monitoring and enforcement of the Credit Contracts and Consumer Finance Act. It is proposed that officials report to the Committee by 31 March 2012 on any fiscal implications.

Human Rights

69. The proposals in this Cabinet paper appear to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.

Legislative Implications

70. The paper proposes amending the Credit Contracts and Consumer Finance Act 2003 and the Credit (Repossession) Act 1997. It may also be necessary to amend the

Financial Service Providers (Registration and Dispute Resolution) Act 2008. The amendments to the CCCFA will also result in amendments to the Credit Contracts and Consumer Finance Regulations 2004 at a later stage.

71. The Consumer Credit Law Amendment Bill has a priority 4 on the 2011 Legislative Programme.

Regulatory Impact Analysis

72. The Regulatory Impact Analysis requirements apply to the proposals in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached.

Quality of the Impact Analysis

73. The Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by the Ministry of Consumer Affairs, and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.

Consistency with Government Statement on Regulation

74. I have considered the analysis and advice of my officials, as summarised in the attached RIS and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- Are required in the public interest,
- Will deliver the highest net benefits of the practical options available, and
- Are consistent with our commitments in the Government Statement on Regulation.

Publicity

75. A press statement on the key decisions from this paper may be made. Those who attended the Financial Summit will be advised of the key decisions.

Recommendations

76. It is recommended that the Committee -

- 1 **Note** there has been reform of the financial sector over the last four years which has significantly changed regulation of financial investments and advisers but has only had a marginal effect on credit providers.
- 2 **Note** that the Credit Contracts and Consumer Finance Act 2003 ["CCCFA"] is the prime legislation applying to consumer credit contracts.
- 3 **Note** that following concerns that the CCCFA is not providing adequate consumer protections against unscrupulous lenders, a Financial Summit was held on 11 August 2011 to identify actions to address irresponsible lending leading to problem debt.
- 4 **Note** there was consensus amongst the participants at the Financial Summit supporting the need for responsible lending regulation and enforcement of registration requirements, alongside non-regulatory industry initiatives and the promotion of financial literacy.
- 5 **Note** a package of initiatives has been developed to address irresponsible lending and promote the responsible provision and management of consumer credit arrangements.

Responsible Lending

6 **Agree** to amend the CCCFA to:

- 6.1 add a new responsible lending purpose to section 3 and principles that exercising the care, diligence and skill of a responsible lender before entering into and throughout the management of a consumer credit contract or lease includes -
 - 6.1.1 credit offered must be reasonably expected to meet the needs or purposes of the borrower (similar language to Consumer Guarantees Act services guarantee);
 - 6.1.2 the borrower must be reasonably expected to repay the loan without substantial hardship; and
 - 6.1.3 the lender must be honest and transparent in dealing with the borrower;
- 6.2 provide for the issue of a Code of Responsible Lending that sets out the types of practices that are accepted as meeting the principles of responsible lending;
- 6.3 provide that not lending responsibly in accordance with the Code of Responsible Lending or the provisions of the Credit (Repossession) Act 1997 is grounds for the regulator to seek a Court Order under section 108 of the CCCFA so that a person may be prohibited from providing credit contracts or leases (and have their registration cancelled under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 [“the Financial Service Providers Act”]);
- 6.4 provide that the regulator can impose conditions on the renewal of the registration of a credit provider under the Financial Service Providers Act if after formal warning a provider has not complied with the Code of Responsible Lending.

Contracts with Unregistered Providers

- 7 **Note** credit providers are required to be registered under the Financial Service Providers Act, but there is evidence that not all third-tier lenders are registered.
- 8 **Agree** to amend the CCCFA to provide borrowers will not be liable for the costs of borrowing (interest, fees and penalties) that would otherwise be owed to a credit provider, that are incurred while that credit provider is not registered as a financial service provider as required by the Financial Service Providers Act.

Credit Advertising

- 9 **Note** irresponsible advertising messages targeting vulnerable, lower socio-economic borrowers, are contributing to problem debt.
- 10 **Note** the Financial Advisers Act 2008 requires advertising by financial advisers must not be misleading, deceptive, or confusing.
- 11 **Agree** to amend the CCCFA to provide that:
 - 11.1 credit advertising must not be misleading, deceptive or confusing and must comply with any requirements of the Code of Responsible Lending;
 - 11.2 regulator also has powers to prohibit advertisements if they are misleading and to give directions to credit providers if they fail to comply with the advertising requirements of the Code of Responsible Lending;

- 11.3 all advertisements for credit (including goods for sale on credit) carry the credit provider's registration number and the name under which they are registered on the Financial Service Providers Register.

Disclosure

- 12 **Note** that the purposes of the CCCFA include the disclosure of adequate information under consumer credit contracts, consumer leases, and buy-back transactions of land ["credit arrangements"] to allow consumers to compare products and be well-informed before making contract commitments.
- 13 **Note** that although the CCCFA requires lenders to disclose specific information about the credit arrangement, there are problems with the timing and content of the disclosure that compromise the purposes of the CCCFA.
- 14 **Agree** to add to the CCCFA that the form and content of disclosure requirements may be prescribed by regulation.
- 15 **Agree** to amend the disclosure requirements for credit arrangements in the CCCFA to:
- 15.1 require that the full contract, key information, and terms of any credit-related insurance products or extended warranty arranged by the lender are disclosed before the contract is signed;
 - 15.2 require that the key information includes information about access to dispute resolution and the hardship provisions;
 - 15.3 require that any goods over which security is taken must be specified in the contract, and the goods that are protected on bankruptcy under the Insolvency Act 2006 are also protected from secured creditors (e.g. and tools of trade, necessary household furniture and effects and a motor vehicle up to the value of \$5,000), except if the credit contract is for the purchase of the item;
 - 15.4 provide for the standard terms and conditions of a lender's credit contracts to be available on the lender's website, or on request by a consumer;
 - 15.5 require the particulars of all credit arrangement variations (even if they reduce a debtor's obligations) to be provided to the debtor in writing; and
 - 15.6 delete the detailed "statement of the right to cancel" in schedule one (which will be replaced by a plain English statement in the amendments proposed below).
- 16 **Direct** the Ministry to prepare amendments to the Credit Contracts and Consumer Finance Regulations 2004 to provide for standard forms to be used for disclosure of the key information of consumer credit contracts within six months of the passage of the CCCFA amendments.

Cooling off period

- 17 **Note** the CCCFA provides for a three working day cooling-off period for credit arrangements but other consumer law is moving to a five working day cooling-off period.
- 18 **Agree** to amend the CCCFA to provide that consumers have five instead of three working days to cancel a consumer credit arrangement.

Fees

- 19 **Agree** to amend the CCCFA to remove the uncertainty concerning the principles for the provisions concerning reasonable fees under consumer credit contracts, and to provide for the Code of Responsible Lending and the new disclosure requirements to cover reasonable fees.

Hardship

- 20 **Note** the CCCFA includes hardship provisions under which consumers may request a change to the terms of a consumer credit contract if the consumer has an unforeseeable change in circumstances (e.g. illness, loss of employment) and is not in default or over their credit limit.
- 21 **Note** requests under the hardship provisions are assessed and approved at the discretion of the lender, and that any agreed contract variation does not reduce the overall amount due under the contract.
- 22 **Agree** to amend the CCCFA to:
- 22.1 provide that debtors can make an application under the hardship provisions if they have been in default for less than two months;
 - 22.2 require the written acknowledgment of receipt of hardship applications within five working days that outlines any further information needed to process the application;
 - 22.3 require lenders to make a decision on a hardship application within 20 working days of receiving the application, or from when the lender received any further information requested from the debtor;
 - 22.4 provide that if a lender does not make a decision on a hardship application within 20 working days, the debtor may apply to the Disputes Tribunal or Court to vary the credit contract as it sees fit;
 - 22.5 preclude the charging of application fees or imposing other obstacles for hardship applications;
 - 22.6 preclude the charging of penalty fees and/or penalty interest while hardship applications are being considered;
 - 22.7 require lenders to advise applicants of the reason their hardship application was declined, and of their right of review.

Oppressive Contracts

- 23 **Note** the CCCFA includes the ability for borrowers or the regulator to apply to the Courts for oppressive credit contracts to be re-opened and modified, but there is no evidence that the oppression remedy has been providing effective protection from unscrupulous creditors.
- 24 **Agree** to amend the test for oppressive credit contracts in the CCCFA to provide that the Courts must have regard to specific consumer protection factors when considering whether a consumer credit contract is oppressive, including the lender's responsible lending obligations.
- 25 **Agree** that disproportionate enforcement and recovery actions by creditors against consumers is one of the factors the Courts must have regard to in deciding whether the exercise of a right or a power under a consumer credit contract is oppressive.

- 26 **Agree** that the regulator has the ability to apply to the Court for an order re-opening all or any of a class of a creditor's consumer credit contracts that are found to be oppressive.

Monitoring and Enforcement

- 27 **Agree** in principle to the further investigation of the Financial Markets Authority being the regulator responsible for monitoring and enforcement of the CCCFA and monitoring of credit repossession practices under the Credit (Repossession) Act 1997.
- 28 **Direct** the Ministry of Consumer Affairs to consult with the Treasury, the Ministry of Economic Development, the Commerce Commission and the Financial Markets Authority on the proposal that the Financial Markets Authority has regulatory responsibility for the CCCFA and the Credit (Repossession) Act, any transitional arrangements and financial implications.

Legislation

- 29 **Note** the Consumer Credit Law Amendment Bill has a priority 4 on the 2011 Legislative Programme.
- 30 **Invite** the Minister of Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office for the Consumer Credit Law Amendment Bill covering the recommendations above.
- 31 **Agree** to the release of an Exposure Draft of the Consumer Credit Law Amendment Bill to allow for consultation on the proposed detailed responsible lending provisions.

Report Back

- 32 **Direct** the Ministry of Consumer Affairs to report back to the Committee on outstanding issues, progress with the drafting of the Consumer Credit Law Amendment Bill, the outcome of any further consultation (which may include consultation on an Exposure Draft Consumer Credit Law Amendment Bill) and the timetable for implementation, by 31 March 2012.

Publicity

- 33 **Agree** to the publication of this Cabinet Paper, the corresponding Minute and the Regulatory Impact Statement on the Ministry of Consumer Affairs website, at an appropriate time.
- 34 **Note** a press release may be made on the main elements of the above recommendations.

Hon Bill English
For Minister of Consumer Affairs

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