

**REGULATORY IMPACT STATEMENT:
RESPONSIBLE LENDING REQUIREMENTS FOR CONSUMER CREDIT PROVIDERS
OCTOBER 2011**

AGENCY DISCLOSURE STATEMENT

1. This Regulatory Impact Statement has been prepared by the Ministry of Consumer Affairs (MCA). It provides an analysis of options to address problems with credit laws. In particular, credit laws do not provide adequate consumer protections against unscrupulous lenders operating at the third tier (loan sharks, fringe lenders). The lending practices of such credit providers result in some people getting into severe financial hardship and spiralling debt. This has economic and social costs for the affected individual, their families and communities.
2. Evidence of the nature of consumer detriment arising from the irresponsible practices of lenders comes from the case files of MCA and community agencies such as budget advisory services, and qualitative research on debt. A quantitative assessment of the magnitude of the detriment has not been made but the case file reporting and qualitative research from multiple sources built up over many years indicate that the consumer detriment needs to be addressed.
3. The analysis of the effectiveness of credit laws began in 2007, with a financial summit held in South Auckland. A discussion paper "Review of the Operation of the Credit Contracts and Consumer Finance Act 2003" setting out some options to improve the Credit Contracts and Consumer Finance Act (CCCFA), was released in 2009. There was a second financial summit discussing these options and 59 submissions were received on the paper. In 2011, the review was broadened to take a more holistic approach and consider the need for reforms to credit laws to achieve improved consumer protection in the same manner as other financial sector reforms based on achieving responsible conduct and sound competence of the participants.
4. The analysis considered both non-regulatory and regulatory policy options and found that reliance on individual responsibility and voluntary guidelines would not be effective in dealing with lenders whose business models take advantage of vulnerable consumers. Participants at the Financial Summit held in August 2011, including credit providers and their industry associations, strongly supported a regulatory approach which would add a responsible lending framework to the CCCFA. However, there has not been consultation on detailed responsible lending proposals. At the Financial Summit, participants were asked for their feedback on broad policy options.
5. The preferred policy approach is to add a new responsible lending purpose and principles to the CCCFA with a package of initiatives based on lenders exercising the care, diligence and skill of a responsible lender. The responsible lending obligations will apply to all lenders, rather than to only some third-tier lenders who appear to cause the most detriment. This approach has been taken because it is important that there is certainty and consistency for both consumers and lenders. For consumers, this means that they are not disadvantaged in the 'quality' of the loan because their circumstances force them to go to a third tier lender. For lenders, there will be a level playing field – lenders will not be able to gain advantage through irresponsible practices. For government, there will not be any regulatory gap that can be gamed, improving the likelihood of compliance and assisting enforcement.
6. The responsible lending proposals are based on similar initiatives in the UK and Australia. The UK responsible lending framework has been in place for about four years and in Australia since July 2010. These initiatives have not been in place sufficiently long

to allow a robust assessment of whether they are effective. We are not aware of particular negative issues with the operation of these responsible lending frameworks.

7. A key element of the responsible lending proposals will be the development of a responsible lending code in consultation with affected credit providers and representatives of consumers and the finance industry
8. The policy options around responsible lending are likely to impose costs on businesses to a greater or lesser degree. The option of a separate licensing scheme for responsible lending practices would impose costs on all credit providers merely through the licensing application process. This option is not favoured. The favoured option imposes responsible lending obligations on all lenders but is unlikely to result in significant added costs for those already behaving responsibly. These lenders already have processes and systems in place to ensure their lending is appropriate to meet the needs of consumers. For example, they have well-documented credit application processes in accordance with good business practice. The lenders which do not have responsible lending practices will face one-off costs to put into place appropriate processes and systems. These costs have not been quantified and will be provider specific depending on the quality of existing processes and systems.
9. Some of the other proposals will also impose one-off costs on lenders. All lenders will be required to rework their key information disclosure statements, and lenders whose advertising does not meet the proposed responsible credit advertising requirements will need to change their advertising. These costs have not been estimated. The cost of changing advertisements should be marginal as businesses change their advertisements regularly. The alternative to the compliance costs is to not take any action which would not address the consumer detriment and costs of the problem that have been identified.
10. The analysis of policy options that has been undertaken is consistent with the Government Statement on Regulations. MCA is satisfied that new regulation is required and the problem cannot be adequately addressed through private arrangements.

Evelyn Cole
Manager Consumer Policy

14 October 2011

OVERARCHING PROBLEM

Status Quo

11. The Credit Contracts and Consumer Finance Act 2003 (CCCFA) is the main law applying to credit providers. This law has two primary policy objectives:
 - Promotion of competition – achieved through requiring disclosure of interest rates and terms and conditions.
 - Protection of consumers – achieved through disclosure, unforeseen hardship protections, oppressive contracts protections and requiring fees are not unreasonable.
12. The Financial Service Providers (Registration and Disputes Resolution) Act 2008 requires credit providers to register and join an approved consumer disputes resolution scheme.
13. Other relevant legislation is the Credit (Repossession) Act 1997, which sets out the rights of lenders and consumers in the area of repossession, and the Fair Trading Act 1986 and the Consumer Guarantees Act 1993.
14. The CCCFA is focussed primarily on consumer responsibility and decision making (with some consumer protections). There are few obligations on the conduct of credit providers. Unless a credit provider is also a bank, non-bank deposit-taker or a financial adviser (which have prudential regulation or licensing requirements), it is only required to register and belong to a dispute resolution scheme. These largely unregulated credit providers are usually referred to as third tier lenders. Approximately a third of identified third tier lenders have not met this obligation¹.
15. The size of the third tier consumer credit market is difficult to establish. In 2010, there was approximately \$517 million outstanding in consumer loans to non-bank lending institutions with assets under \$100 million (excluding building societies and credit unions)². This figure will include third tier lenders. This equates to around 4 per cent of total consumer loans³. Approximately 130,580 people have used a third tier lender in the past 24 months⁴ and there are 218 companies that have been identified as third tier lenders⁵.
16. The number of third tier lender outlets has increased significantly since 2006, indicating increased demand and opportunities for third tier lenders in the harder economic times of the past few years. About half (95) of the lenders who were in business in 2006 have exited the market and 127 new lenders have entered the industry⁶. The number of new lenders and the turnover since 2006 reflects the ease of market entry and exit.
17. A fuller statistical analysis of credit provision and issues is set out in “Background Statistics for Considering Credit Issues” produced by MCA for the 2011 Financial Summit <http://www.consumeraffairs.govt.nz/legislation-policy/policy-reports-and-papers/research/Background-Statistics-for-Considering-Credit-Issues-2011.pdf>

¹ The Ministry of Consumer Affairs. Third-tier Lender Desk-based Survey 2011. Wellington: Ministry of Consumer Affairs, 2011

² Data provided by the Reserve Bank of New Zealand 15 July 2011.

³ Reserve Bank of New Zealand. Housing and Consumer Loans Outstanding by Institutional Group. Wellington: Reserve Bank of New Zealand, 2010.

⁴ Colmar Brunton for the Ministry of Consumer Affairs. *Using a third tier lender: experiences of New Zealand borrowers*. Wellington: Ministry of Consumer Affairs, 2011.

⁵ The Ministry of Consumer Affairs. Third-tier Lender Desk-based Survey 2011, op cit

⁶ Ibid

The problem

18. Existing credit law is focused on consumer responsibility and decision-making (and the promotion of competition with some consumer protection). This is achieved mostly through information disclosure to enable the selection of the most appropriate credit arrangements. The focus on consumer responsibility and choice has resulted in a credit regime in which there are few obligations for credit providers to behave responsibly, especially towards vulnerable borrowers.
19. There are lenders who are market leaders in good practices, but evidence from the case files of MCA and community organisations, such as budget advisory services and community law centres, and qualitative research from MCA and the Families Commission, indicates that the practices and conduct of some third tier lenders results in consumer detriment when debt becomes a problem. Consumer detriment associated with problem debt includes: difficulty meeting food, health and transport needs; repossession of essential household items; threats to personal safety by repossession agents; and the negative impact on mental wellbeing and on relationships.
20. The root cause of consumer detriment from problem debt is that a sizeable number of people have little option but to borrow from non-mainstream sources because they are financially disadvantaged and mainstream credit is not available to them. Banks and other mainstream lenders are reluctant to lend to borrowers with poor credit histories. There has always been demand for credit from third tier lenders, but this is particularly so in times of recession and/or credit squeezes. The market is not providing credit to these borrowers on the same favourable terms as are available from mainstream lenders, and in this environment, exploitative lending can flourish.
21. Some lenders take advantage of consumers' vulnerability, such as a lack of sophistication when dealing with credit providers (financial literacy), the urgent need for credit to make non-discretionary payments, and English being their second language. Some unscrupulous third tier lenders 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 that loans are repaid according to the terms of the loan is less vital to the lenders and may in fact be counter to their interests.
22. Problems with the timing and content of information disclosure are also limiting the value of the information available to consumers. The oppression and hardship protections for consumers under the existing law are also of limited practical value.
23. The advertising by third tier lenders tends to focus on ease, speed and normality of third tier loans and they provide credit to their target market with 'no questions asked', disguise its high cost. They also back up debt collection with threats and seizing essential household items.
24. Lenders are not required to meet any competency or conduct standards, and before December 2010, did not have to register or belong to a dispute resolution scheme. MCA found that a third of identified third tier lenders do not appear to be registered and thus also do not belong to a dispute resolution scheme.⁷ This is of particular concern as it is third tier lending consumers who often require the most protection.

⁷ The Ministry of Consumer Affairs. Third-tier Lender Desk-based Survey 2011, op cit

Measure of Consumer Detriment / Magnitude of Problem

Nature of detriment

25. Evidence of the nature of detriment resulting from the practices or conduct of lenders comes from the case files of MCA, community organisations (such as budget advisory services and community law centres) and qualitative research on credit and debt. Some excerpts from qualitative research follow:

“Loans from finance companies and purchasing on credit from mobile shops were particularly problematic forms of consumer credit. The high cost of using these forms of credit contributed to a cycle of debt for many beneficiary families. Difficulties in keeping up with debt repayments created additional interest and administration charges. Some families reported that they did not always understand the consumer credit contracts they signed. Other families understood what they were committing to (e.g. more expensive forms of credit, higher interest rates) but felt their poor credit rating or inability to save up cash for a purchase gave them no alternative.” *Families Commission. Escaping the Debt trap: Experiences of New Zealand Families Accessing Budgeting Services. Wellington: Families Commission, 2009.*

“Being in debt can result in a huge toll, emotionally and practically, on some families. The most significant impacts of debt on these families were:

- difficulty in meeting food, transportation and health needs
- difficulty in engaging in activities that could be considered normal for other families, and this could result in becoming socially isolated
- negative impacts on the mental well-being of family members
- negative impacts on relationships within the family and with extended family.

Half the beneficiary families and one working family had experienced repossession of items.” *Families Commission. Escaping the Debt trap: Experiences of New Zealand Families Accessing Budgeting Services. Wellington: Families Commission, 2009.*

“...fringe lenders appear to be the credit provider of first resort for most Pacific consumers. While some...indicate understanding of their responsibilities and obligations as consumers, and were very aware of the costs involved in what they were going into, often this did not translate into beneficial decisions and actions. Moreover, the data reveal that some customers' lack of quite basic financial literacy, coupled with the fringe industry's aggressive advertising campaigns and the manner in which they present complex contractual details, leads to situations that greatly disadvantage Pacific consumers financially and which often result in high levels of personal and family stress and hardship.” *Pacific Consumers' Behavior and Experiences in Credit Markets with particular reference to the "Fringe Lending" Market. Wellington: Ministry of Consumer Affairs, 2007.*

Magnitude of detriment

26. There is no direct measure or quantitative assessment of the number of people or households that have suffered detriment from the irresponsible practices of lenders. An indication of the magnitude of the problem can be obtained from the following statistics:

- An estimated 130,580 New Zealanders have borrowed from a third tier lender in the past 24 months⁸. It must be emphasised here that not all third tier lenders lend irresponsibly or that all users of third tier lenders suffer detriment;

⁸ Using a third-tier lender: experiences of NZ borrowers, August 2011, Colmar Brunton for the Ministry of Consumer Affairs

- 15 percent of people seeking help from the New Zealand Federation of Family Budgeting Services had problems with debt from finance companies (many of whom are third tier lenders), however, they may not have got into that situation because of irresponsible lending; and
- From 2007 to 2010, the average amount of debt for people presenting to them increased by 63%, and the average debt arrears increased by 16 percent from \$4250 to \$4950⁹;
- The number of people who have been granted Summary Instalment Orders and No Assets Procedures (consumer debt mechanisms to avoid bankruptcy) increased from 1300 in 2007 to 3350 in 2010, an increase of 160 percent (some of the increase will be because the two mechanisms were introduced in 2007)¹⁰.

Business detriment

27. The detriment for business is that the current legal and policy settings incentivise bad market behaviour, and create an opportunity cost to lending responsibly. Consumer credit providers which might be interested in lending responsibly have an incentive to act exploitatively, or to adopt predatory practices, and in some cases the lowest common denominator seems to have become the market standard.

The likely consequences of taking no policy action / Cost of Status Quo

Costs to consumer

28. Some borrowers will continue to:

- get loans that they cannot really afford, resulting in less money for other needs such as food and healthcare;
- pay more for their loans than need be;
- suffer financial hardship and mental illness or relationship difficulties directly related to problem debt;
- have their personal safety threatened and essential household items seized by repossession agents.

Cost to business

29. Those credit providers which are also banks, deposit-takers and financial advisers, already have added obligations and costs under the regulatory regime for those services. These include prudential supervision and conduct and competency standards. The requirements under these regimes are likely to apply across the whole business including credit provision. Lenders which are not banks, deposit-takers and financial advisers may have a competitive advantage in that they may have lower compliance costs and are free to conduct their business with few constraints.

Cost to government

30. The detriment suffered by consumers because of exploitative lending, such as financial difficulty, puts pressure on government and agencies such as Work and Income NZ, budget advisory services and city missions.

⁹ New Zealand Federation of Family Budgeting Services

¹⁰ Insolvency and Trustee Service

Objectives of government action

31. Reforms in the financial sector since 2008 have had the following objectives:

- *A sound and efficient financial system;*
- Investment which encourages growth and innovation;
- An environment which facilitates wealth accumulation;
- Confidence in the sector which encourages participation by consumers and market participants;
- *To better protect consumers;* and
- To meet international commitments and standards.

32. The italicised objectives are most relevant to these proposals. A sound financial system would address areas of significant consumer detriment, and would provide effective protection for consumers who are borrowers as well as depositors or investors.

33. The existing framework for consumer credit law already includes information disclosure, promotion of competition and consumer protection, and the proposal is to add responsible lending. The framework can be shown as follows:

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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REGULATORY IMPACT ANALYSIS OF SPECIFIC PROPOSALS

Responsible Lending	
Status Quo	There is no requirement to lend responsibly, or to assess the ability of a consumer to repay the loan. The CCCFA does provide that fees may not be unreasonable. Some credit providers have a duty to act with care, diligence and skill as the Financial Advisers Act applies to them. Many third-tier lenders are not covered by this regime.
The consumer problem and its source/ What is the problem?	<p>The worst problem is that some unscrupulous third tier 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 that loans are repaid according to the terms of the loan is less vital to the lenders and may in fact be counter to their interests.</p> <p>There have been general problems with irresponsible lending and debt management including unsolicited credit card limit increases without any checks to establish whether the consumer is in a position to financially sustain the increased limit, assigning debt collection to a third party that does not have an interest in working with the consumer to address the debt issue, not processing hardship applications in a timely manner (discussed more fully later), and not following up on outstanding loan amounts in a timely manner. There are also lenders who have good practices.</p>
Measure of Consumer Detriment/Magnitude of Problem	<p>The behaviour of unscrupulous lenders can have serious financial consequences for those consumers who are the most vulnerable as outlined in the overarching problem discussion above.</p> <p>It is difficult to establish the size of the third tier credit market. Overall it is a small part of the market for credit. An estimated 130,580 New Zealanders have accessed credit from third tier lenders in the past 24 months and 218 companies have been identified by MCA as third tier lenders.</p> <p>This sector of the market appears to be growing as the number of outlets identified by MCA has increased significantly since last recorded in 2006, suggesting possible growth in the demand for third tier products. Not all third tier credit transactions result in consumer detriment and many consumers value the services of third tier lenders.</p> <p>Qualitative research has been collated from a number of sources¹¹ on the experiences of consumers who use third tier lenders and establishes areas in which consumer detriment occurs.</p> <p>Common trends can be seen across the research which point to consumer detriment arising from interaction with the third tier credit market. The magnitude of the problem cannot be quantified from the qualitative research, but issues that can be deduced from the research include:</p>

¹¹ Escaping the Debt trap: Experiences of New Zealand Families Accessing Budgeting Services, 2009, Families Commission. In depth interviews with 47 people who had accessed budget advisors and advisors themselves. Using a Third Tier Lender: experiences of New Zealand borrowers, August 2011, Colmar Brunton for MCA. In depth interviews with 24 people who had used third tier lenders in the past 24 months. Pacific Consumers' Behaviour and Experiences in Credit Markets with particular reference to the "Fringe Lending" Market, 2007, Anae, Melani, and Eve Coxon, for MCA. This report focussed on Pacific communities in South Auckland. In depth interviews with 62 individuals and community agencies as well as ten focus group sessions. Case files of MCA.

	<ul style="list-style-type: none"> • Borrowing in the third tier credit market is primarily by those on a low income or benefit, and is commonly for necessities. This suggests an inelastic demand for credit regardless of the cost, and that consumers have limited incomes and may struggle to meet repayment obligations. • Many consumers have numerous loans to different credit providers or refinance or receive top up loans. A consumer with many loans may have greater difficulty in meeting payments, suggesting that lenders may not be concerned about the level of debt a consumer has at the time of lending, and as such may be evidence of irresponsible lending. • Many consumers are offered additional credit after they have repaid or mostly repaid their debts. This can lead to a cycle of debt or debt spiral. • Many borrowers leave it to the lender to advise them as to how much they should borrow. • Many consumers in the third tier market have particular characteristics which make them vulnerable when entering into credit contracts such as: an urgent need for finance, low levels of financial literacy, lack of knowledge of their rights, and English as a second language. • Consumers seeking personal loans from third tier lenders do not shop around for credit and do not choose a credit provider based on the total cost of credit. They consider factors such as the speed of accessing credit, the likelihood that the lender will lend to them, the amount of the weekly repayment and a friendly service more important. • Debt spirals or problem debt (which can result from the provision of inappropriate credit) can have the following negative outcomes for consumers: difficulty meeting food, health and transport needs, social exclusion, and can impact on mental wellbeing and on relationships. <p>Participants at the 2011 Financial Summit from community groups discussed similar concerns as those outlined above. These findings (common across research) point to a credit market in which consumers are in a position to be exploited by unscrupulous lenders and this can lead to negative outcomes for them and their families. The commonality of issues across different research suggests systemic problems for consumers in this market.</p> <p>The <i>Third-tier Lender Desk-based Survey</i> indicated that: many third tier lenders are small operators; there are high levels of entry and exit; and 30-40% may not be complying with registration requirements under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.</p>
Measure of Business Detriment	Outlined in overarching problem discussion above.
The likely consequences of taking no policy action/ Cost of Status Quo	If the status quo remains, some consumers will continue to receive unsuitable credit, including credit which they do not have the capacity to repay. The costs noted above in measure of consumer detriment will continue and may be compounded. There may be an incentive for more lenders to operate unscrupulous practices.
Objectives of government action	To promote responsible lending to achieve a sound and efficient financial system and to better protect consumers.

POLICY OPTIONS – RESPONSIBLE LENDING

<p>1. No change</p>	<p>MCA does not favour this option.</p> <p>The measure of detriment to consumers, businesses and government are outlined above. The benefit of the status quo is that there will be no additional costs on business (which may also be passed on to consumers) associated with further legislated requirements.</p>
<p>2. Providing responsible lending obligations through the CCCFA and linking these to the existing registration regime of the Financial Service Providers (Registration and Dispute Resolution) Act</p>	<p>This is MCA's preferred option.</p> <p>Under this approach the legislation would be amended to add the purpose to promote the responsible provision and management of consumer credit contracts and consumer leases. Included is 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:</p> <ul style="list-style-type: none"> • 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. <p>. A breach of the principles of responsible lending is grounds for the regulator to seek a Court Order that a person may be prohibited from providing credit contracts or leases.</p> <p>The legislation would provide for the issue of a Code of Responsible Lending that sets out the types of practices that are accepted as meeting the purpose and principles of responsible lending. Dispute resolution schemes may use the Code as a standard to judge a lender's behaviour. To further incentivise registration, a consumer would be relieved from paying the costs of borrowing (interest and fees) where a contract is with an unregistered credit provider.</p> <p>This option is broadly in line with the responsible lending obligations in the Australian Commonwealth National Consumer Credit Protection Act 2009. Credit Licensing: Responsible Lending Conduct guidelines set out ASIC's expectations for meeting the responsible lending obligations of this Act.</p> <p>Consumer Benefits</p> <p>The consumer detriment outlined above from the provision of unsuitable credit products would be mitigated. Because the new regime may result in some of the less scrupulous lenders exiting the market this may result in consumers of third tier lenders broadening their search for credit. The result of the proposals should be an overall reduction in the cost of credit for more vulnerable consumers. Similar provisions are in place in the UK and Australia. While they haven't been in place long, initial indications are that they are having a positive impact.</p> <p>Consumer Costs</p> <p>There may be additional process costs for lenders which will be passed on to consumers by way of higher charges. As good lenders already undertake proper checks to assess a consumer's ability to pay, the additional cost for most lending should be minimal, if any.</p>

	<p>Business Benefits</p> <p>The provisions may result in some of the less scrupulous lenders exiting the market, resulting in a more level playing field among responsible lenders and those that might be lending irresponsibly, especially in the second and third tier.</p> <p>The Financial Service Providers Act requires that all credit providers be registered. This Act, alongside the CCCFA, has a mechanism for the enforcement of responsible lending without the need for a separate licensing regime. Using this pre-existing registration regime mitigates any additional costs that a separate, additional licensing regime would entail.</p> <p>Business Costs</p> <p>There is an uncertainty cost for lenders concerning whether a loan is considered suitable. This cost will be mitigated by having a code which will be developed in close consultation with industry. The code will need to meet regulatory impact analysis standards. The intention is that providers complying with Australian legislation (e.g. the Australian trading banks) will have no additional costs.</p> <p>There are costs associated with lending responsibly. Most lenders already undertake proper checks to assess a consumer's ability to pay, the additional cost for most lenders should be minimal, if any. There will be costs on those lenders who are not already lending responsibly.</p> <p>Benefits to Government</p> <p>This option increases the possible tools available which could be used by the regulator and dispute resolution schemes. As the proposals are similar to the Australian model, NZ can take advantage of their experience and guidelines.</p> <p>Costs to Government</p> <p>There will be regulatory implementation costs associated with developing the Responsible Lending Code. There could be increased costs related to enforcement of the new provisions.</p>
<p>3. Providing separate licensing scheme for responsible lending practices.</p>	<p>MCA does not favour this option.</p> <p>This approach would see an additional, separate credit providers licensing regime that is centred on the responsible lending obligations. A credit provider would be required to apply to the licensing authority for a credit licence prior to being able to provide consumer credit. MCA considers that the compliance costs to business from having to be licenced under an additional regime outweigh any likely benefits above the preferred approach.</p> <p>Benefits</p> <p>Compared to the preferred approach, having a separate credit providers licensing regime would provide a more direct mechanism for the enforcement of responsible lending provisions. The preferred approach attaches competency and conduct requirements to a negative registration scheme. Separate licensing provisions and the preferred approach both have a cost to Government as the regulator needs to establish a lender has not practised responsible lending.</p> <p>Consumer Costs</p> <p>The additional costs to businesses associated with separate licensing provisions may ultimately be passed on to consumers by way of higher charges.</p>

	<p>Business Costs</p> <p>Compared to the preferred approach this option imposes additional compliance costs on business in attaining a licence. For some providers it would mean a fourth layer of licensing to be a credit provider.</p>
<p>4. Industry- led regulation of responsible lending</p>	<p>MCA does not favour this option.</p> <p>The Financial Services Federation in early 2011 developed responsible lending guidelines for its members to follow. The Banking Code of Practice includes some responsible lending conduct rules. The Financial Services Federation guidelines have been adopted by its 34 members.</p> <p>The threat of regulation could provide the credit industry the incentive required to conform to the existing voluntary responsible lending approach or implement alternative responsible lending practices.</p> <p>Industry-led regulation works well when there is a cohesive industry, prepared to commit to voluntary standards. The MCA third-tier research indicates that there are many credit providers who are not complying with the registration requirements in the law and the requirement to belong to consumer dispute resolution. Approximately 35-40 per cent of third tier lenders have not met the most basic legal requirement of registration. Without a strong industry commitment it is unlikely that an industry-led approach will be sufficient to ensure improved conduct by lenders.</p> <p>Feedback from all groups at the Financial Summit 2011 indicated that self-regulation would not be effective in this case and some level of government intervention is required.</p> <p>Benefits</p> <p>The advantages of an industry self-regulation approach to responsible lending are centred in improved efficiencies compared to more direct and active government regulation by allowing the free market to work without government intervention.</p> <p>Consumer Costs</p> <p>Any self-regulation approach is unlikely to receive universal support. This is particularly true for a responsible lending regime in a market with poor cohesion which will provide an incentive for some credit providers to avoid any obligations. An industry-led approach will see the greatest adoption from those who already exhibit responsible lending practices. This will lead to an inconsistent lending environment.</p> <p>Business Costs</p> <p>An industry-led regulatory approach would create an unfair advantage for those who choose to flaunt the guidelines.</p> <p>Even if backed by principles based regulation the self-regulation approach does not provide for certainty as to requirements for credit providers.</p> <p>Overall, there would be fewer costs to business when a voluntary approach to responsible lending is taken compared to the costs associated with a mandatory approach. This is simply due to the flexibility that a voluntary system allows.</p>

Disclosure	
Status Quo	<p>One of the purposes of the CCCFA is the disclosure of adequate information to consumers under credit contracts, consumer leases and buy-back transactions for land (“credit arrangements”):</p> <ul style="list-style-type: none"> • to enable consumers to distinguish between competing credit arrangements or competing lease arrangements • to enable consumers to become informed of the terms of consumer credit contracts or consumer leases before they become irrevocably committed to them, and • to enable consumers to monitor the performance of those arrangements (including variations to them). <p>The CCCFA requires disclosure of key information about credit arrangements (such as the interest rates and payments required) and the full terms and conditions of the contract.</p> <p>The key information requirements do not include information about hardship or access to consumer dispute resolution.</p>
The consumer problem and its source/ What is the problem?	<p>While the disclosure objectives are working in some areas, such as the ease of comparing mortgage interest rates, for many consumer credit arrangements, the disclosure objectives are not being met.</p> <p>For borrowers from third tier lenders, the disclosure requirements are not enabling the comparison of credit contracts, or enabling consumers to make informed decisions about what they are committing to.</p> <p>The source of the problems are:</p> <ul style="list-style-type: none"> • Lenders have five working days after the contract is agreed to disclose key information and the full terms and conditions of the contract, and 15 working days to disclose the terms of credit-related insurance products or extended warranties they have arranged for the consumer • The key information is not always expressed clearly and concisely • Lenders do not have to make their standard terms and conditions publicly available • Contract variations do not always have to be in writing • There are limited requirements to disclose information about consumer protections and to itemise secured goods.
Measure of Consumer Detriment/Magnitude of Problem	<p>A recent desk-top review by MCA of 38 third tier lenders found that only three (8%) had standard terms and conditions on their websites, whereas all five major banks did so.</p> <p>Mystery shops by Consumer NZ¹² and MCA officials found that some third tier lenders were reluctant to provide this information making it hard for consumers to compare terms and conditions between lenders.</p>

¹² “Cringe Lending”, Consumer Magazine, May 2011. Consumer NZ

	<p>A recent Colmar Brunton survey (commissioned by MCA) of 24 borrowers found that while 19 (79%) appeared to have been given at least basic information about their loan details, nine (47%) of those users came away with a limited understanding of the loan terms and conditions. The research also found that those with pay-day or pawn shop loans generally had a better understanding of the loans terms and conditions – probably because these types of contract are more straightforward.</p> <p>Submissions to MCA after the Financial Summit also indicate that some borrowers have difficulty understanding their contractual obligations or the consequences of default.</p>
Measure of Business Detriment	There is little evidence that the existing provisions cause detriment to lenders, although lenders may get into disputes with consumers that feel misled by poor disclosure.
The likely consequences of taking no policy action/ Cost of Status Quo	<p>Reduced competition by not allowing consumers to compare terms and conditions leads to reduced incentives for lenders to provide better information.</p> <p>Consumers with unsuitable contracts are paying more than they need to, which can lead to a debt spiral if they cannot meet the repayment requirements. Even if they do meet the repayments, it can have an impact on other aspects of their lives, e.g. reduced priority of other expenses, such as power and healthcare.</p> <p>Avoidable disputes that are difficult to resolve will continue to arise over verbal contract variations.</p> <p>Consumers will continue to lack information about dispute resolution, options when facing unforeseen financial hardship, and what goods can be repossessed.</p> <p>The disclosure requirements will continue to be inconsistent with both Australia and the United Kingdom, where “pre-disclosure” of certain information is required before a credit contract is agreed.</p>
Objectives of government action	To support responsible lending and the promotion of competition, and to protect consumers from unreasonable lender behaviour.
POLICY OPTIONS – DISCLOSURE	
1. No change	MCA does not favour this option. The consumer detriment would not be addressed by the status quo.
2. Improved information disclosure requirements	<p>This is MCA's preferred option. This option provides for:</p> <ul style="list-style-type: none"> • requiring the full contract, related key information, and terms of any credit-related insurance or extended warranty services arranged by the lender to be disclosed before the contract is signed; • inclusion of information about dispute resolution (e.g. how to complain to a lender and who that lender's approved financial dispute resolution provider is) and about the hardship provisions (e.g. how to apply) in the key information; • requiring key information to be in plain English and in a simple

	<p>standard form by developing regulations setting out how the disclosure should be presented;</p> <ul style="list-style-type: none"> • disclosure of specific / itemised secured items • 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. • the particulars of all contract variations (e.g. even if they reduce a debtor’s obligations) to be provided to the debtor in writing. <p>Benefit</p> <p>Consumers are provided with the information before signing the contract, with key information set out clearly. This enables them to compare and think about the contract before they sign. Some consumers may find that the contract is not advantageous to them and seek a better deal.</p> <p>Consumers would also be fully aware of any variations to their contract and be aware of their rights during disputes or hardship.</p> <p>Lenders may find less time is spent on disputes or debt management if the contracts better suited their clients.</p> <p>Consumer Costs</p> <p>These requirements may delay the provision of credit for those consumers with an immediate need. It is envisaged that this would be a short-term cost as lenders adapt their processes to incorporate speed and better disclosure.</p> <p>Business Costs</p> <p>There should not be a cost to having information available up front rather than up to five days later. There is no change in the actual need for disclosure.</p> <p>Lenders will need to rework their disclosure of key information to add information on dispute resolution and hardship. This a one-off cost. Some lenders will have to put information up on their websites. There will be a one-off initial cost and on-going costs to ensure the website is up-to-date.</p> <p>Competition may be increased between lenders. This may mean some lenders would need to amend their terms and conditions, or lose customers. It may reduce their profit and some may go out of business. This is only likely for businesses that are not flexible or adaptable.</p> <p>Costs to Government</p> <p>There are no direct costs to government.</p>
3. Education /Financial Literacy	<p>MCA does not favour this option.</p> <p>Providing education to the general public regarding credit contracts can be achieved via public good advertising and education within schools. The costs can be borne by either financial institutions (as part of responsible lending/licensing obligations) or government.</p> <p>Benefit</p> <p>Improved financial education has many benefits in that it provides consumers with the tools to avoid unmanageable debt and seek help when necessary. It increases consumer confidence in the credit market and</p>

	<p>encourages businesses to provide suitable services to be competitive.</p> <p>Consumer Costs</p> <p>Improving financial literacy is important, but fundamentally people need to have good information to base “educated” decisions on. Increased education will not help if consumers do not have the information they need about the specific credit contract they are signing up to.</p> <p>Government Costs</p> <p>Publicity campaign costs would be borne by government. Education campaigns are expensive and need to be on-going. There is already government expenditure on financial literacy. It may be possible to direct some of this expenditure to promoting informed credit decisions.</p>
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Credit Advertising	
Status Quo	There is an Advertising Standards Authority (ASA) Code for Financial Advertising. The Fair Trading Act applies to advertising – it cannot misrepresent or be misleading or deceptive. In comparison, the Financial Advisers Act provides that financial adviser advertising must not be misleading, deceptive or confusing.
The Consumer Problem and its Source/what is the problem?	<p>Irresponsible credit advertising contributes to increased demand by consumers for credit in the third tier market. Credit advertising often includes messages which promote borrowing in an irresponsible manner to lower socio-economic consumers for example:</p> <ul style="list-style-type: none"> • Promoting credit being available quickly and easily to anyone who may consider their access to credit restricted (low income earners, beneficiaries or those with a poor credit history); • Presenting information about the cost of credit in a misleading manner (stating the amount of the weekly repayment without stating how long it will take to repay the debt, or giving a percentage interest rate which is not annual, such as a weekly rate); • Lack of transparency about the credit provider (promoting goods for sale on credit without stating the credit provider or failing to clearly state who the advertised credit provider is or whether they are registered, e.g. one advertisement just states “call Marina”). <p>MCA views the above advertising practices as broadly irresponsible.</p>
Measure of consumer detriment / Magnitude of problem	<p>MCA research^{13]} has established that messages such as “no credit checks” or “bad credit history, no problem” are very common features of third tier credit advertising.</p> <p>Colmar Brunton research shows credit advertising is a highly influential driver of demand for credit in the third tier market and messages which</p>

^{13]} This research established that these messages appear very frequently in the newspaper and online advertising of third tier lenders. Third-tier Lender Desk-based Survey, July 2011, MCA.

	<p>promise no credit checks or to lend to beneficiaries are particularly attractive to high risk consumers¹⁴.</p> <p>Third Tier credit advertising almost never includes information about the cost of credit which is understandable, accurate and widely applicable¹⁵.</p>
Measure of Business Detriment	Because consumers are highly responsive to irresponsible credit advertising messages and show a high degree of loyalty to their lenders ¹⁶ , irresponsible credit advertising disadvantages other non-bank lenders who do not use irresponsible messages.
The likely consequences of taking no action/cost of the Status Quo	As noted above, irresponsible credit advertising contributes to more consumers entering unsuitable or unaffordable credit contracts. This can have a number of personal and social costs where it leads to over indebtedness ¹⁷ .
Objectives of government action	To support the promotion of responsible lending and to better protect consumers from misleading, deceptive or confusing advertising.
POLICY OPTIONS – CREDIT ADVERTISING	
1. No change	MCA does not favour this option. The consumer, business and government detriment noted above will not be addressed.
2. Add a provision to responsible lending requirements of the CCCFA that advertising should not contravene the principle of lending responsibly, specify that it not be misleading, deceptive or confusing and require credit advertising (including for goods	<p>This is MCA's preferred option.</p> <p>Benefits</p> <p>This provision is complementary to the responsible lending principle proposed for the CCCFA.</p> <p>Vulnerable consumers would not be subject to the influence of messages which target their desperate circumstances. Lenders would be unable to state that they will lend to consumers in a way that is contrary to the responsible lending principles. They would thus be unable to gain a competitive advantage from doing so.</p> <p>Inclusion of a lender's registration name and registration number would facilitate easy checks of registration for businesses and consumers and supports registration enforcement in a low cost manner. This would also</p>

¹⁴ Respondents stated that along with friends and family, advertising was the most common way in which they found and chose a third tier lender. They looked for messages such as: "will lend to beneficiaries" "no credit checks" and "no security required". Using a third tier lender: experiences of New Zealand borrowers, August 2011, Colmar Brunton for MCA.

¹⁵ No newspaper advertising reviewed included useful cost of credit information. Some websites of payday lenders included cost calculators. Third-tier Lender Desk-based Survey, July 2011, MCA.

¹⁶ Repeat borrowing is common in the third tier credit market and consumers will often choose to return to a lender with whom they have a previous relationship. Using a third tier lender: experiences of New Zealand borrowers, August 2011, Colmar Brunton for MCA.

¹⁷ The impacts of debt on families include: difficulty meeting food, health and transport needs, social exclusion, negative impact on mental wellbeing and negative impacts on relationships. These issues have cost implications for government agencies. Escaping the Debt trap: Experiences of New Zealand Families Accessing Budgeting Services, Families Commission, 2009.

<p>available on credit) to include the lender's name and registration number.</p>	<p>facilitate easy complaints about credit advertising to the ASA and the regulator because the advertiser is easily identifiable¹⁸.</p> <p>A test of "mislead or confuse" is a lower test than the Fair Trading Act test of "misleading or deceptive" so should cover a greater number of negative behaviours.</p> <p>Consumers costs</p> <p>Consumers may face a more time-consuming information search if the provision leads to less credit advertising.</p> <p>Business Costs</p> <p>Lenders would face a restriction on the manner in which they advertise. Some lenders who wish to promote their flexible lending criteria may lose a competitive advantage.</p> <p>Costs to Government</p> <p>There are no direct costs to government.</p>
<p>3. Introduce specific requirements for credit advertising, such as:</p> <ul style="list-style-type: none"> • Requiring the inclusion of the annual percentage rate (APR) • Regulation of the lenders' websites • Restrictions like those in place in the United Kingdom¹⁹ and Australia²⁰. 	<p>MCA does not favour these options.</p> <p>Benefits</p> <p>These provisions could see regulation used to prohibit phrases which imply that credit will be available to people who would normally expect their access to credit to be restricted (this may include beneficiaries or those with a poor credit history).</p> <p>The provisions may encourage greater consumer information which could promote competition.</p> <p>Costs</p> <p>These provisions may make lenders less likely to include certain information if it is a trigger requiring more information in the advertisement, meaning that ultimately consumers may have less information available.</p> <p>Lenders may have compliance difficulties making the required information available in advertisements such as newspapers, radio or billboards.</p> <p>This may not be the most useful stage to make cost of credit information available. It could more helpfully be given to the consumer in the form of pre-contractual disclosure.</p>

¹⁸ This provision was called for very strongly during the Financial Summit at which one breakout group featured a discussion on credit advertising. The ASA has only received 21 complaints against the Code for Financial Advertising in the past two years, however, a review of advertising review found that many third tier advertisements contravene the principles in the code (Third-tier Lender Desk-based Survey, July 2011, Ministry of Consumer Affairs)

¹⁹ The United Kingdom Consumer Credit (Advertisements) Regulations 2010 require any advertisement to include a representative example of the terms of the credit contract where any amount relating to the cost of credit is mentioned, where there is an implication that credit will be provided to people who would consider their access to credit restricted or where there is an incentive to apply for credit.

²⁰ The Australian National Consumer Credit Protection Act 2009 requires an annual percentage rate to be stated in any advertisement which includes information relating to the cost of credit.

	<p>Government Costs</p> <p>There would be costs in enforcing specific regulations.</p>
<p>4. Work with the Advertising Standards Authority to develop a new Code for Financial Advertising and educate community media about compliance</p>	<p>MCA does not favour this option exclusively but will aid the ASA in the development of a new Code for Financial Advertising</p> <p>Benefits</p> <p>Dealing with complaints through industry self-regulation by the ASA is very quick. The ASA takes on average 25 working days to process a complaint.</p> <p>This option would not have associated costs of enforcement.</p> <p>Costs</p> <p>The ASA system of self-regulation relies on consumer complaints about advertising. Anecdotal evidence suggests that consumers in the third tier market are unlikely to complain about advertising. Complaints about breaches of the Code for Financial Advertising are infrequent (the ASA has received just 21 complaints against the code in the past two years).</p> <p>Third tier lenders are unlikely to comply with self-regulation. Approximately 35-40 per cent of third tier lenders have not met the most basic legal requirement of registration. Without a strong industry commitment it is unlikely that such an approach will be sufficient to ensure improved conduct by advertisers.</p> <p>The ASA may be limited in controlling the types of media favoured by third tier lenders. The ASA has good relationships with mainstream media such as television and compliance by mainstream media is strong. However, these media would appear not to be favoured by third tier lenders (this is likely due to their high cost). According to the Nielson Media Company in 2010 only six per cent of the third tier lenders were found to have advertised on television at any time during the year.</p> <p>As a comparison, 19 per cent had advertised in at least one community newspaper (on a single day) and 54 per cent have their own website. Small community newspapers and websites are more difficult to monitor and may be less likely to comply with the ASA.</p>

Oppression	
Status quo	<p>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.</p> <p>The oppression remedy applies to all credit contracts (including commercial and consumer credit contracts). The legal protection available to consumers who may be vulnerable to lenders that have predatory or exploitative business practices could be improved.</p>
The consumer problem and its source/ What is the problem?	<p>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 or exploitative creditors, even when the terms of their contracts or the conduct of the creditor seem from a consumer</p>

	<p>protection point of view to be harsh, unjustly burdensome or unfair.</p> <p>The overarching test for oppression as it is applied by the Courts is whether the transaction meets “reasonable standards of commercial practice.” The test is essentially discretionary, and the Courts have consistently held that the reasonable standards of commercial practice include the creditor being able to receive the benefit of a “good deal” from their perspective.</p> <p>Most of the oppression cases have involved commercial or investment cases, and the legal tests from those cases have tended to reinforce the understanding that the remedy is not available to protect consumers from impecunious transactions.</p> <p>Very few High Court cases have ever held (for example) that very high interest rates or fees payable by consumers are oppressive. Generally the “successful” consumer cases have involved defences to summary judgment applications or mortgagee sale interim injunctions, which do not create authoritative court precedents.</p> <p>Some consumers have had more success in the Disputes Tribunal, but there are still very few successful cases, and Disputes Tribunal decisions have no authority as legal precedents.</p>
<p>Measure of Consumer Detriment/Magnitude of Problem</p>	<p>Evidence from the case files of MCA and community organisations such as budget advisory services and community law centres, and qualitative research from MCA and the Families Commission, show that the practices and conduct of some third-tier lenders result in consumer detriment.</p> <p>If the oppression remedy was working effectively, it would provide legal protection for those consumers incurring detriment from exploitative business practices by creditors. That is not the case.</p> <p>One of the reasons the CCCFA is not providing sufficient protection for consumers is that financially harsh outcomes from high-cost loans that could not be characterised as responsible lending are not regarded by the Courts as being contrary to reasonable standards of commercial practice or inherently oppressive under the CCCFA. Under the current law, creditors have no requirement to lend responsibly because, according to reasonable standards of commercial practice, parties to contracts are responsible for assessing the suitability of the transactions they enter into.</p>
<p>Measure of Business Detriment</p>	<p>Ineffective consumer protection against the exploitative business practices of some credit providers is primarily a consumer detriment problem.</p> <p>The secondary detriment for business is that the current legal policy settings incentivise bad market behaviour, and attach an opportunity cost to lending responsibly. Consumer credit providers that might be interested in lending responsibly have an incentive to act exploitatively, or to adopt predatory practices, and in some cases the lowest common denominator seems to have become the market standard.</p>
<p>The likely consequences of taking no policy action/ Cost of Status Quo</p>	<p>The consequence of the status quo being retained is that one of the key protections for consumers in the CCCFA will remain largely ineffective.</p> <p>The significance of this needs to be considered in the context of the other changes proposed to the CCCFA, especially the introduction of a</p>

	<p>responsible lending regime.</p> <p>The new remedies associated with responsible lending will be available, but those remedies are primarily regulatory remedies that relate to the registration status of the lender. The remedies available to consumers will be through the dispute resolution schemes that the lenders are required to be part of under the Financial Service Providers (Registration and Dispute Resolution) Act 2008, but the oppression remedy under the CCCFA will remain as a backstop available through the Courts.</p> <p>The backstop remedy of oppression is also available to the regulator, which is another reason why it is important that it should be effective.</p> <p>It is possible that the responsible lending changes made to the CCCFA will alter the market context sufficiently that the Courts will regard the reasonable standards of commercial practice (which underpin the oppression test) as having shifted. If this happens, the oppression remedy could become more effective without needing to be amended. However it would be a risk to rely on the Courts making such a change without providing an express direction in the Act for them to do so. The Courts have consistently shown a preference for giving effect to contracts between lenders and borrowers, largely regarding borrowers as being responsible for the choices they make.</p> <p>At best, relying on the common law to evolve in a way that takes responsible lending into account would be inefficient. It would involve uncertainty and high transaction costs for the affected parties. At worst, this approach might not work.</p>
Objectives of government action	To improve consumer protections for those that are vulnerable to the practices of unscrupulous lenders, contributing to a sound and efficient financial system and better protection of consumers.
POLICY OPTIONS – OPPRESSION	
1. No change	<p>MCA does not favour this option as it does not address the consumer detriment and business detriment noted above.</p> <p>By not making any change to the oppression test, the current certainty associated with the oppression provision would be retained. However, this certainty provides very little protection for consumers.</p> <p>Consumer Costs</p> <p>The cost for consumers of the status quo is that the legal remedy of having consumer credit contracts reopened by the Courts (including the Disputes Tribunal) is not available in cases which seem to be unfair, harsh or unjust, but where the loan is in accordance with reasonable standards of commercial practice from the Court's (and the lender's) perspective.</p> <p>Business Costs</p> <p>The status quo generates opportunity costs for creditors which choose to lend responsibly because their competitors are not held to account for acting exploitatively towards their borrowers. That lack of accountability creates incentives for lenders to engage in exploitative and predatory lending practices because they are profitable, and in some cases the</p>

	<p>lowest common denominator seems to have become the market standard.</p> <p>Government Costs</p> <p>There would be no marginal costs to the Government from maintaining the status quo.</p>
<p>2. Amend the CCCFA to distinguish between general credit contracts and consumer credit contracts for the purposes of the oppression protection, and rebalancing the oppression test to increase the protection available to consumers by providing new factors for the Courts to apply in considering whether a consumer credit contract is oppressive.</p>	<p>This is MCA's preferred option (in conjunction with Option (4) below).</p> <p>The emphasis in the current test for oppressive credit contracts on the reasonable standards of commercial practice is too permissive for lenders, and is failing to provide protection for consumers against harsh or exploitative lending practices by some creditors. The test could be 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.</p> <p>The current guidelines that the Courts are required to have regard to in section 124 of the CCCFA could also be modified by adding consumer protection factors for consumer credit contracts. The consumer protection factors could be based on the unjust credit contract criteria listed in the Australian National Credit Code, such as the relative bargaining power of the parties, whether there was independent legal advice, the quality of the understanding of the borrower, the terms of comparable transactions, and the pricing of the risk to the lender.</p> <p>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.</p> <p>Benefit</p> <p>This option would improve the availability of the protection under the CCCFA for consumers from oppressive credit contracts and creditor conduct. This would enhance the enforcement by consumers (and the regulator) of lenders' responsible lending obligations.</p> <p>Consumer Costs</p> <p>The risk with any attempt to provide greater legal protection for consumer borrowers (including adding responsible lending obligations and capping the cost of credit) is that creditors may choose to exit the market rather than comply with the new obligations. The risk also applies to lenders which rely on business practices which could be regarded as oppressive. If those lenders withdraw from the market rather than modifying their business practices, then consumers' access to credit would reduce.</p> <p>The self-enforcement model underpinning the existing oppression remedy in the CCCFA imposes a cost on consumers. The self-enforcement costs are likely to limit the effectiveness of the remedy for consumers under the existing law, and under any amendment that continues to rely on self-enforcement by consumers. The regulator also has the opportunity to enforce the existing oppression provisions, but it does not tend to do so.</p> <p>Business Costs</p> <p>Reducing the opportunity for some lenders to engage in business practices which are exploitative or predatory, but which do not currently meet the test</p>

	<p>for being oppressive, would reduce the profits of those businesses.</p> <p>Lenders who are accused of having contract terms or conducting themselves in ways that are oppressive will incur costs if they choose to defend themselves, as well as the costs of any remedies the Courts may provide for consumers in those circumstances.</p> <p>Government Costs</p> <p>Improving access to the oppression remedy for consumers could increase Justice costs for the Government. Expanded enforcement could also increase the regulator's enforcement costs.</p>
<p>3. Amend the CCCFA to provide that any finance cost (interest and fees) above a regulated capped rate is deemed to be oppressive.</p>	<p>MCA does not favour this option.</p> <p>If a finance rate cap is supported by the Government it would be preferable to state this clearly. This approach is being considered in Australia with special provisions for small amount short term loans.</p> <p>If the cost of credit (interest and fees) is capped along the lines proposed in Australia, one of the ways of backing up the enforcement of those rules would be to provide that any breach of the cap is deemed to be oppressive under the CCCFA. This could be a rebuttable presumption.</p> <p>This option also has the potential to distort the oppression remedy in cases where the other elements of oppression might not be made out.</p> <p>Benefit</p> <p>It would be efficient from a law drafting point of view to use the existing oppression remedy to enable the Courts to reopen consumer credit contracts that breach any cap that might be put in place.</p> <p>Consumer Costs</p> <p>The potential consumer costs are associated with the cost of credit cap, rather than from a proposed remedy to enforce the cap. If the arguments in favour of a cap are accepted, there would be no additional cost for consumers in being provided with a new remedy.</p> <p>The self-enforcement model underpinning the existing oppression remedy in the CCCFA does however impose a cost on consumers. The self-enforcement costs are likely to limit the effectiveness of the remedy for consumers under the existing law, and under any amendment that continues to rely on self-enforcement by consumers.</p> <p>Business Costs</p> <p>A cap on the cost of credit would impose an opportunity cost on lenders which would otherwise have loaned money at rates higher than the cap. If the arguments in favour of a cap are accepted, then the only additional cost to business through providing this remedy would arise from the enforcement of the cap. Lenders which breach the cap will incur costs if they choose to defend themselves under the rebuttable presumption that breaching the cap is oppressive. They would also incur the costs of any remedies the Courts may award against them.</p> <p>Government Costs</p> <p>Broadening the oppression remedy to include credit costs that exceed a</p>

	cap on credit costs could increase Justice costs for the Government. Enhanced enforcement powers could also increase the regulator's enforcement costs.
4. Amend the CCCFA to provide that a disproportionate enforcement of an outstanding debt is oppressive.	<p>MCA prefers this option, in conjunction with Option (2).</p> <p>One of the exploitative behaviours by lenders can be to use the threat of enforcement or taking and realising securities they hold which are disproportionate to the amount of a default.</p> <p>The time given for a borrower to remedy a default and the creditor refusing to release any security having regard to the extent of the security and the obligations secured are factors the Court must already have regard to in deciding whether the conduct of a lender is oppressive.</p> <p>The Court could also be 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.</p> <p>Benefits</p> <p>This amendment would increase the protection available from the Courts (including the Disputes Tribunal) under the CCCFA for consumers who are subjected to recovery actions by creditors which are disproportionate to the amount of the default or debt. Disproportionate recovery actions involve an element of unfair leverage or threat to force the borrower to repay the debt.</p> <p>Consumer Costs</p> <p>There would be no cost to consumers from giving them greater protection from lenders which conduct recovery actions that involve unfair leverage or threats against consumers.</p> <p>Business Costs</p> <p>There may be benefits for creditors undertaking disproportionate recovery actions which they would lose if the CCCFA was amended to provide a remedy against such conduct.</p> <p>Lenders which are accused of undertaking recovery actions that are oppressive will incur costs if they choose to defend themselves, as well as the costs of any remedies the Courts may provide for consumers in those circumstances.</p> <p>Government Costs</p> <p>There would be no marginal costs to the Government above the potentially increased Justice and enforcement costs from Option (2).</p>

Hardship provisions	
Status Quo	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, injury, loss of employment). Hardship applications can only be made if the debtor is not in default or over their credit limit. There is no onus on lenders regarding how

	they should deal with applications (such as a time limit on processing applications). Some credit providers, particularly banks and larger second tier lenders, will consider hardship applications when a person is in default.
The consumer problem and its source / What is the problem?	Consumers using the hardship provisions can be frustrated by delays and can have their debt increased further by extra fees and interest. Some consumers cannot make use of the hardship provisions because they are already in default.
Measure of consumer detriment / Magnitude of problem	Consumer advisers often deal with situations where debtors have applied under the hardship provisions, but end up in dispute with the lender about repayments or other obligations. Disputes range from the lender denying an application was made, to disagreements over what arrangements were made, and default fees that may have been incurred. This occurs at a time when the debtor is likely to be facing stressful personal circumstances. Research and information from consumer advisers ²¹ indicates that many hundreds of people who seek advice on debt issues every quarter could benefit from more accessible hardship provisions, and that many people do not seek help with their debt until they are in default.
Measure of business detriment	Lenders possibly receive more complaints from customers (that can result in disputes) due to the limited requirements on them regarding the processing and notification of hardship applications – it is not clear what applicants should expect to happen. “Responsible” lenders are not operating on a “level playing field”.
The likely consequences of taking no policy action / cost of status quo	Consumers suffering unforeseen financial difficulty will continue to miss out on the benefits of having reasonable changes to their repayments as an alternative to getting into further debt or having assets repossessed.
Objectives of government action	To improve consumer protection for people having difficulties meeting their obligations under credit contracts due to unforeseen financial hardship.
POLICY OPTIONS – HARDSHIP	
1. No change	MCA does not favour this option. The consumer detriment would not be addressed by the status quo.
2. Place more responsibility on lenders when dealing with hardship applications	This is MCA’s preferred option. This option places more responsibility on lenders by: <ul style="list-style-type: none"> • extending the provisions so that debtors can apply if they have been in default for less than two months • requiring lenders to acknowledge and process applications within five and 20 working days respectively – see note below • banning application fees / “qualifying tests” for hardship applications; • banning penalty fees and/or penalty interest while hardship applications are being considered; • requiring lenders to advise applicants of the reason their hardship application was declined, and of their right of review

²¹ Based on 2009 information from two Auckland based Citizens Advice Bureaux and Families Commission research.

	<p>Benefit to consumers</p> <p>More consumers will be able to access the hardship provisions, reducing the chances of their debt becoming unmanageable.</p> <p>They will also have certainty about their application (i.e. that it was received, that it will be processed in a timely way). In addition, people suffering unforeseen hardship will not have to incur extra costs while their application is being considered.</p> <p>Benefit to business</p> <p>If contract variations under the hardship provisions are successful, lenders should benefit from having fewer bad debts.</p> <p>Cost to consumers</p> <p>The added business costs incurred by lenders will be passed on to consumers in the cost of credit. However, the cost per consumer will be low as it will be spread over many customers.</p> <p>Cost to business</p> <p>Many lenders (including major banks and third-tier lenders) already allow debtors in default to make applications under the hardship provisions so there will be a relatively low overall cost of extending the provisions.</p> <p>Successful hardship applications do not reduce the debtor's obligations – the costs to the lender are in processing and considering the applications. Increasing lender responsibilities with respect to hardship applications will increase these costs, particularly the requirement to make a decision within 20 working days.</p> <p>Costs to government</p> <p>There are no direct costs to government.</p>
3. Education	<p>MCA does not favour this option.</p> <p>Both consumers and lenders could be better educated about the existing hardship provisions and their rights and obligations under them. However, much of the problem is that the provisions are limited, and do not place much responsibility on lenders to follow good process.</p> <p>There would therefore only be a marginal benefit to consumers from increased education about the existing provisions. This would likely be outweighed by the costs.</p> <p>Increased consumer awareness of the hardship provisions should result from the proposals to improve the information disclosure requirements, which is relatively low cost.</p>
4. Open-ended hardship provisions (the Australian model)	<p>MCA does not favour this option.</p> <p>In Australia, there is no limit on how long a debtor can be in default before applying under the hardship provisions.</p> <p>This option is likely to face strong opposition from lenders and is not necessarily better for consumers as it does not encourage people to get timely help. Two months is considered a reasonable period of time for a debtor (in stressful personal circumstances) to contact their lender to make a hardship application.</p>

CONSULTATION

34. An operational review of the CCCFA commenced in 2008 following a financial summit in November 2007, which was attended by about 100 representatives from industry, consumer groups and government. The review looked at how the CCCFA was meeting its objectives five years after coming into effect. A discussion paper on this review was released and a second financial summit was held in September 2009. The discussion paper covered information disclosure and hardship and fifty nine submissions were received. Submitters expressed the following views:
- **Information Disclosure:** Submitters supported up front disclosure for vehicle credit (which was proposed) and some consumer groups called for up front disclosure for all credit contracts.
 - **Hardship:** Consumer groups and some industry bodies supported:
 - Allowing applications from consumers who have been in default for less than two months
 - Time limits and no fees for processing hardship applications
35. On the appointment of the current Minister of Consumer Affairs in May 2011, the objective of the credit review broadened to include problem debt, particularly to address issues in the third tier market. A more holistic approach was adopted, consistent with the approach taken in the financial sector reforms.
36. A third Financial Summit was held in August 2011 that was attended by about 250 representatives of community agencies, credit providers, industry associations, dispute resolution service providers and government agencies. The attendees from industry included the main banks, credit unions and larger and smaller third tier lenders. The Summit had the objective of determining an action plan with initiatives for addressing problem debt, and the promotion of responsible lending and debt management.
37. To facilitate effective discussion and feedback, participants were allocated to discussion groups covering the spectrum of problem debt issues. Each group had a chair that reported back the group's findings and commentators from industry or with consumer perspectives to comment on them. The topics of the discussion groups were: attitude changing and financial literacy, credit advertising, access to affordable credit, responsible lending, responsible debt management, dealing with those in financial difficulties and dispute resolution
38. The Summit resulted in a high level of consensus across a number of topics with participants calling for:
- **Responsible lending:**
 - Legislated provisions tied to a registration regime;
 - To apply throughout the credit contract;
 - To apply to a lender's advertising; and
 - To apply to all market participants.
 - **Disclosure:**
 - Key information to be included in a simplified standardised form with disclosure documentation;
 - Clearly set out the cost of credit;
 - Include information about disputes resolution services and unforeseen hardship;
 - Itemised disclosure of items to be used as security.
 - **Enforcement:**
 - Active enforcement of the registration requirement.

- **Unforeseen hardship:**
 - Allow applications from consumers who have been in default for less than two months
 - Time limits and no fees for processing hardship applications
- **Contracts with unregistered credit providers:**
 - Contracts with unregistered credit providers to be voided or unenforceable.

39. Following the Summit, participants were invited to make further submissions on issues raised. MCA received 15 submissions, which largely reiterated what was said at the summit, but also offered more information that informed policy proposals.

RECOMMENDATIONS

The preferred options are set out in the table below – it is recommended that they proceed as a full package. The proposals are based on the concepts of promoting responsible lending, along with improved information disclosure and consumer protections. The options are interconnected and will have the greatest effect when combined.

Responsible lending	Information disclosure	Protection of consumers
<p>Lenders must exercise the care, diligence and skill of a responsible lender at time of considering a credit application and throughout the contract term</p> <p>Put in place a Responsible Lending Code that sets out the expectations regarding meeting the minimum standard to exercise the care, diligence and skill of a responsible lender</p> <p>Require any advertising to not be misleading, deceptive, confusing and must be in accord with the Responsible Lending Code</p> <p>Provide for the regulator to impose conditions on the renewal of registration if a formal warning has been given that a lender may not be complying with Responsible Lending obligations</p> <p>Add to CCCFA that not lending responsibly in accordance with the Code</p>	<p>Standard contract terms and key information must be on lenders website or otherwise available.</p> <p>Disclosure of:</p> <ul style="list-style-type: none"> • the key information, and • full terms and conditions of the consumer credit arrangements <p>must occur before the contract is made (present requirement allows for disclosure up to five working days after the contract is made)</p> <p>Require key information to include information on dispute resolution and hardship provisions</p> <p>Add new regulation-making power to prescribe the form in which the key information must be disclosed</p> <p>Require any credit contract variation must be in writing</p> <p>Require any goods over which security for a loan is taken must be specified in the contract</p> <p>Provide a five working day cooling-off period following the making of a consumer credit</p>	<p>Excuse borrower from 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)</p> <p>Add to the oppressive credit contract provisions specific tests for consumer credit contracts separate from business credit contracts</p> <p>Allow hardship applications if in default for less than two months, require lenders to process applications in defined times and provide reasons why an application is declined, and preclude application and default fees</p> <p>Provide that goods protected on bankruptcy under the Insolvency Act 2006 are also protected from secured creditors (e.g.</p>

of Responsible Lending or requirements of the Credit (Repossession) Act is grounds for disqualification of registration	contract (currently three working days).	tools of trade, necessary household furniture and effects and a motor vehicle up to the value of \$5,000), except if the contract is to buy such an item
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IMPLEMENTATION

40. The recommended policies will be implemented through the Consumer Credit Law Amendment Bill (which has a priority 4 on the 2011 Legislative Programme). This Bill will amend the Credit Contracts and Consumer Finance Act 2003. There will be subsequent amendments to Credit Contracts and Consumer Finance Regulations 2004. A further Regulatory Impact Statement will be made addressing these amendments.
41. There will also be a Code of Responsible Lending issued by Order in Council on the recommendation of the Minister of Consumer Affairs. The Code will be developed by MCA in consultation with the credit industry and will then be enforced by the regulator. A further Regulatory Impact Statement will be required when the Code of Responsible Lending is recommended.
42. The Cabinet Paper recommends a separate report back by 31 March 2012 on outstanding issues, progress with the drafting of the Consumer Credit Law Amendment Bill, the outcome of any further consultation (including consultation on an Exposure Draft) and the timetable for implementation.

MONITORING, EVALUATION AND REVIEW

43. It is proposed that there is a requirement to review the effectiveness of the new laws and to report back to Parliament within five years of the legislation coming into force.
44. A separate project will be undertaken to enable the review, which is likely to involve updated qualitative research on the experiences of borrowers from lenders in general, including third-tier lenders, as well as compliance information from credit providers and the regulator. Benchmarks statistics will also be established for monitoring and evaluation. The case files of MCA and community agencies will also be monitored to determine if the nature of the issues with lenders change after the new laws are introduced.