MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT
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Review of consumer credit regulation

Additional information to support the discussion paper

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About this report

This report accompanies the discussion paper, *Review of Consumer Credit Regulation*, and provides additional information about the issues and options addressed by the paper.

This report serves the following purposes:

- It documents what is known, and not known, about the issues, and the evidence that supports our assessment of the issues.
- It provides further detail on the technical design of the options, and how they might work in practice.
- It provides more information about the costs and benefits of the options, and any evidence that supports this assessment.

The report is based on what is known to us as at the time of releasing the discussion paper, following desk-based research and consultation with around 30 stakeholders (listed in Annex 1).

The consultation process on the discussion paper, and the further research and analysis involved in developing policy recommendations, is expected to provide a more substantial evidence base, better designed options and a more complete and confident assessment of the costs and benefits of the options (regulatory impact analysis). The regulatory impact analysis will be summarised in an Impact Statement that informs the Government’s decisions on further reform of the CCCFA.

In addition to the answering the questions in the discussion paper, we would welcome separate comments on this document. In particular, you may wish to comment on the following questions for issues and options you have an interest in:

- Have we correctly identified and described the issues? Do you have any information or data that sheds light on their frequency and severity?
- Do you agree with our assessment of the costs and benefits of the options? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
- Do you have any suggestions for the further design of options? If so, what would be the impact of your proposed design on borrowers, lenders and the credit markets?

Contents

Glossary

ASIC	Australian Securities and Investments Commission
borrower	Only borrowers under consumer credit contracts are covered by the CCCFA. Businesses, trustees, etc. are not included in the term 'borrower' in this report.
CCCFA	Credit Contracts and Consumer Finance Act 2003
the Code	The Responsible Lending Code made under section 9G of the CCCFA
creditor	A person who provides, or may provide, credit under a credit contract. This includes persons to whom the rights to the debt are transferred by assignment or by operation of the law (e.g. a debt collector who buys a loan from a creditor).
default fees or default interest	Additional charges payable by the borrower on a breach of a credit contract.
EIR	Equivalent interest rate, which combines interest charges and fees into a single annual rate.
FSPR	Financial Service Providers Register
FCA	United Kingdom Financial Conduct Authority
FTA	Fair Trading Act 1986
high-cost lenders	Lenders who charge a very high annualised interest rate. In the Responsible Lending Code, this refers to an interest rate over 50% per annum.
mobile traders	Businesses that do not have fixed retail premises and sell goods predominantly on credit. These include mobile shopping trucks and traders who sell goods on credit door-to-door using catalogues and brochures.
MBIE	Ministry of Business, Innovation and Employment
phoenix companies	Companies which are liquidated or otherwise wound up (sometimes to avoid fines or other liabilities), but whose directors and managers then restart it under a new name and FSPR number.

1 Status quo

1. The Credit Contracts and Consumer Finance Amendment Act 2014 passed into law on 6 June 2014, as part of the Credit Contracts and Financial Services Law Reform Bill. The amendment act made a range of changes to the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**), with most of the substantive amendments coming into force 12 months later – 6 June 2015.

2. Changes included new lender responsibilities (including the Responsible Lending Code), new requirements for repossessions, changes to information disclosure and greater penalties for some breaches of the CCCFA. These are summarised below. A more detailed summary is ***available on the Commerce Commission's website***.

Lender obligations under the 2015 CCCFA reforms

Overarching responsibility to be a responsible lender: every lender must, at all times exercise the care, diligence, and skill of a responsible lender.

Assist borrowers to reach informed decisions: Lenders must assist borrowers and guarantors to reach an informed decision as to whether to enter into the agreement and be reasonably aware of the full implications of doing so. This applies when lenders communicate with borrowers and guarantors, including in advertising.

Credit contracts must be suitable for the borrower: Lenders must make reasonable inquiries to be satisfied that the agreement likely meets the borrower's requirements and objectives. These inquiries might relate to the purpose for which the credit is sought, the timeframe for which the credit is required and whether the borrower requires flexibility or particular product features.

Credit contracts must be affordable for the borrower: Lenders must be satisfied that the borrower or guarantor will likely make the payments under the agreement without suffering substantial hardship. They must be able to meet essential day-to-day expenses and any other financial commitments.

New disclosure requirements: An initial disclosure statement must be given to borrowers before the credit contract is entered into (previously it could be given afterward). Lenders must now publish interest, fees and standard-form contract terms on their websites.

Increased safeguards for consumers subject to repossession: a number of new requirements were introduced, including licensing of repossession agents.

1.1 Responsible Lending Code

3. Because the lender responsibilities are relatively high-level principles-based obligations, the reforms also provided for a ***Responsible Lending Code*** (the Code) to provide practical guidance on ways to meet these obligations.

4. The Code contains guidance for lenders to comply with their legal obligations under the CCCFA. Compliance with the Code is not mandatory, but can be used as evidence of compliance with the lender responsibilities. An overview of guidance in the Code is provided in the table below.

Responsible Lending Code chapter	Guidance is provided on…
Obligations that apply before and throughout an agreement (Chapter 2)	Compliance policies, procedures and training, and contacting borrowers and guarantors
Advertising (Chapter 3)	General practices, specific practices, and guidance for advertising of high-cost credit agreements (including risk warnings)
Inquiries into and assessment of borrowers' requirements and objectives (Chapter 4)	The scope of inquiries, method of inquiries and extent of inquiries
Inquiries into and assessment of substantial hardship (borrowers) (Chapter 5)	The scope of inquiries, method of inquiries and extent of inquiries, application to pawnbroking, and need for verification of information provided by the borrower
Inquiries into and assessment of substantial hardship (guarantors) (Chapter 6)	The scope of inquiries, method of inquiries and extent of inquiries, and need for verification
Assisting borrowers to make an informed decision (Chapter 7)	Communicating key features, providing more assistance to vulnerable consumers, and the manner of presenting information
Assisting guarantors to make an informed decision (Chapter 8)	Key information that should be communicated to guarantors, and circumstances in which more assistance may be needed
Credit-related insurance and repayment waivers (Chapter 9)	Assessing the borrower's requirements and objectives, making insurance payments without substantial hardship, assisting informed decisions, advertising
Fees (Chapter 10)	Guidance on setting fees in light of Supreme Court decision in *MTF/Sportzone*
Subsequent dealings (Chapter 11)	Making information available to borrowers, increasing credit limits, ensuring borrowers make informed decisions about variations
Default and other problems (Chapter 12)	Specific acts that lenders shouldn't do, informing the borrower about missed payments, consideration of proposed repayment plans, responsible exercise of enforcement rights and complaints
Repossession (Chapter 13)	Decision to repossess, action after warning notice, and action after repossession
Oppression (Chapter 14)	Avoiding undue pressure and dealing carefully with borrowers who may not be able to protect their own interests

1.2 Implementation of the 2015 reforms

5. Many organisations and government agencies were involved in implementing the 2015 changes. These include:

   a. lenders, many of whom spent significant time and resources in 2014/15 ensuring that systems and procedures were in place to ensure compliance with new and amended obligations, and who continue to implement systems and procedures to ensure compliance over time

   b. the Commerce Commission, which is responsible for monitoring and enforcement of compliance with the CCCFA by lenders, and which engages with lenders, borrowers and advocates about CCCFA responsibilities and rights

   c. the Consumer Protection team at MBIE, which publishes online and offline resources for consumers and advocates, and supports a call centre for consumer phone enquiries. The Consumer Protection team developed and refreshed online and offline resources for consumers. The ***consumerprotection.govt.nz*** website includes a specific section on the CCCFA, including the Responsible Lending Code and model disclosure statements. An updated guide to "What to know when borrowing money or buying goods on credit" was published, and is distributed by community service providers.

   d. consumer advocates and community service providers, who provide advice, information and support to borrowers on credit-related matters, including the Citizens Advice Bureau, Community Law Centres, the Salvation Army, and other budgeting and financial capability services

   e. dispute resolution services to which borrowers can bring disputes with lenders regarding obligations under the CCCFA.

Commerce Commission implementation

Educative initiatives for consumers and industry

6. Since the 2014 credit reforms the Commerce Commission has undertaken the following activities to promote compliance with the law:

   a. produced a Know Your Rights consumer brochure "Buying Goods on Credit" in English, Tongan, Samoan, te reo Māori, simplified Chinese, Hindi and Korean

   b. produced guidance material for both consumers and lenders such as the Credit Fees Guidelines, Disclosure Guidelines and Repossession Guidelines as well as a number of new factsheets

c. established nationwide Lender Seminars to better inform the lending sector on credit law and the Commission's enforcement priorities

d. established nationwide Community Credit Forums to inform the consumer advisory sector of the law changes, consumers' rights and how to report possible breaches to the Commission

e. developed Red Flags as a targeted reporting tool for the consumer advisory sector to help consumer advisors better identify possible breaches and make reports to the Commission

f. produced a series of animations called "It's All Good" to promote consumer rights when borrowing money. The animations were supported with resources for teachers and have been distributed to more than 500 intermediate and secondary schools around the country.

g. conducted compliance workshops for lenders providing credit to Pacific Island communities

h. produced an annual consumer issues report identifying current issues and emerging risks that have the potential to affect markets or consumers.

Investigations and enforcement

7. In 2014, the Commission launched an industry investigation into the mobile trader industry and produced the Mobile Trader report. As a result of that the Commission issued 29 compliance advice letters and subsequently prosecuted 13 traders for CCCFA and Fair Trading Act 1986 (FTA) breaches.

8. Between July 2014 and February 2018 the Commerce Commission has:

   a. completed 245 CCCFA investigations

   b. recorded a 22% increase in CCCFA complaints with the majority of complaints about irresponsible lending practices

   c. issued 9 warning letters, received 18 judgments on CCCFA cases, and entered into 4 settlements.

9. Between January 2014 and May 2018:

   a. Lenders returned $4.64 million to consumers as a result of action taken under the CCCFA

   b. The courts imposed fines of $2.18 million as a result of CCCFA breaches.

2 Problem definition

Overall issues with problem debt and consumer harm

10. The discussion paper sets out a number of specific issues in the credit markets and with the operation of the amended CCCFA. These issues, which are described in further detail below, include the excessive cost of some credit agreements, continued irresponsible lending and non-compliance, continued predatory behaviour by mobile traders, unreasonable fees and harmful debt collection practices.

11. These issues are believed to contribute, along with a wide range of other societal factors, to a high prevalence of problem debt in sections of the community, and associated harms. Problem debt worsens financial hardship by siphoning income into repayments (including interest and fees), and unmanageable debt is a source of ongoing emotional and financial stress for families. It particularly affects vulnerable people and those already in hardship.

12. There appears to be relatively little data on the extent of problem debt in New Zealand and its contribution to harm.

13. One social service provider that works with low income families advised that 95% of its client families were carrying unaffordable debt. This represented 900 children and their families (75% of which were Pacific people and 15% Māori).

14. Two Whānau Ora sub-providers (one working with Pacific people and the other with Māori) advised that most of their client families are struggling with unmanageable debt.

15. A survey of 74 Māori Housing New Zealand tenants by one of these providers found that they held the types of debt shown in Figure 1. Government debt was most prevalent, with loans and overdue bills also featuring significantly. Most of these tenants face hardship – 89% of tenants said that they run out of food due to lack of money at least sometimes, with many running out of food every week. Figure 2 shows that most of the survey respondents had less than $5000 of debt, although many had more.

Figure 1 Types of debt held by sample of Housing NZ tenants

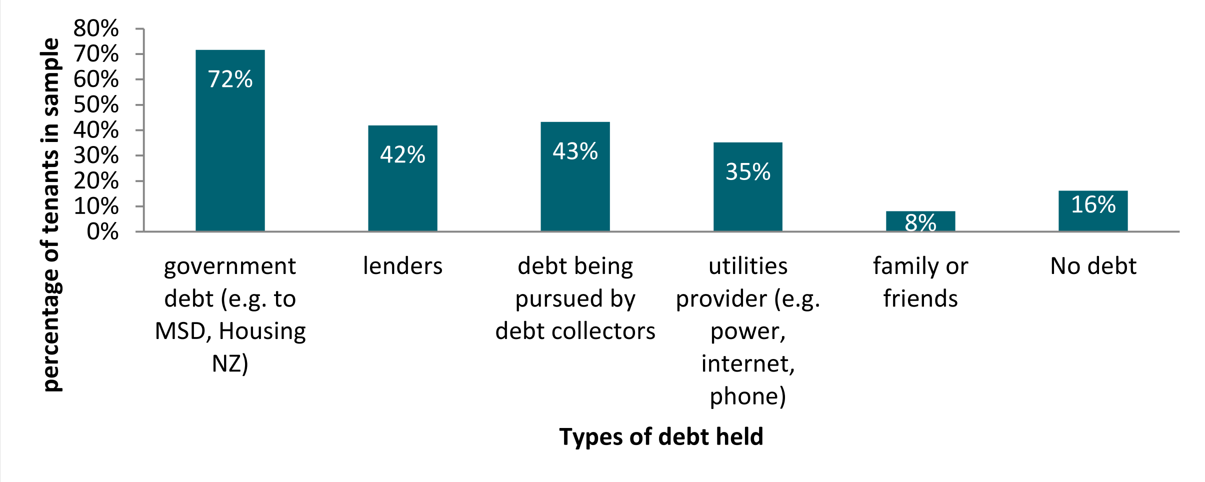
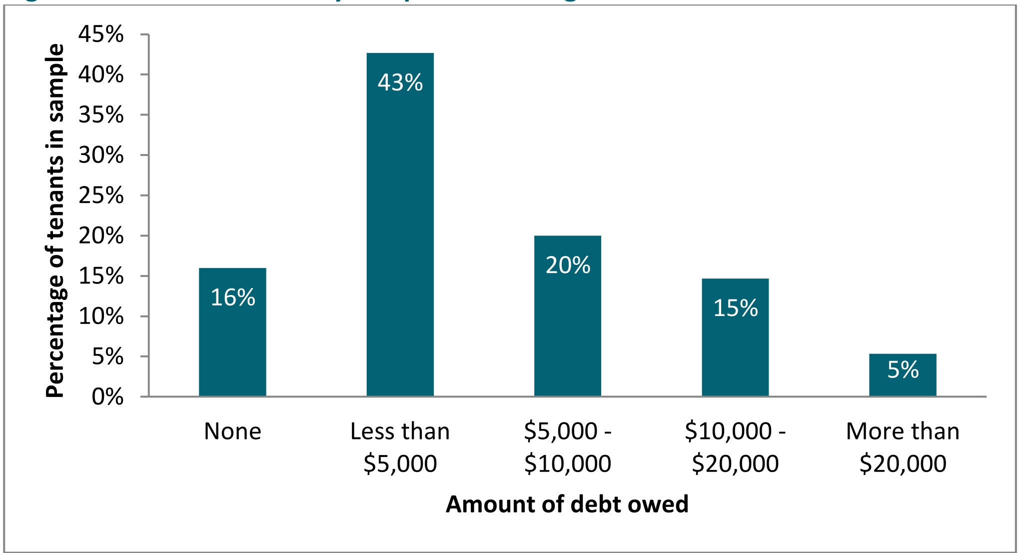


Figure 2 Size of debt held by sample of Housing NZ tenants



Issue 1: Excessive cost of some consumer credit agreements

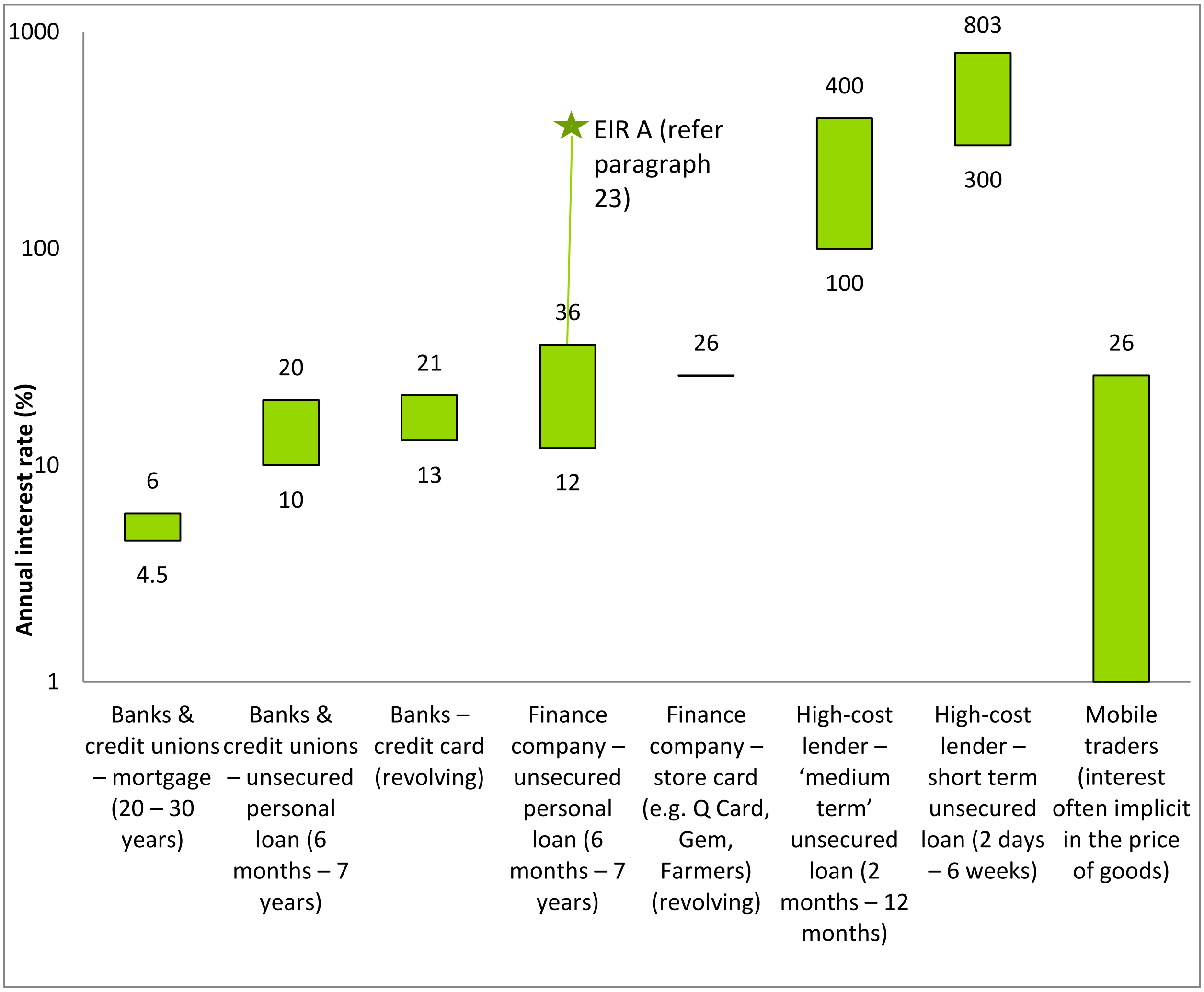
16. Some lenders offer small loans over short timeframes. These credit products are referred to as 'high cost' on the basis of their high annual interest rates, or when compared against products offered by 'mainstream' lenders such as banks, credit unions and finance companies.

17. Historically, short-term lenders have provided credit to people who, due to their credit histories, may not qualify for credit elsewhere. This is a large number of consumers – we understand that 30-35% of New Zealand adults have 'impaired' or sub-prime credit scores.[1] The high interest rates charged are generally explained as being the result of the

[1] This estimate was shared by a lender stakeholder, and is based on data from two credit reporting agencies.

higher default risk from these borrowers, as well as the higher transaction costs relative to the size of the loan.

18. The chart below shows general terms and interest rates across different types of lending products in New Zealand. The rates are displayed in their annualised form to enable comparison.



19. There is a disjunction between most finance companies, which charge up to around 36% p.a., but more commonly below 30% p.a., and high-cost lender rates that range from 100-400% p.a. for a 3-12 month loan, and are many hundreds of percent interest p.a. for a short (under six week) loan.

20. In many cases, high-cost lenders are offering products where there are no 'mainstream' loans of an equivalent amount and term available. For example, mainstream finance companies rarely offer loans for terms of less than six months and in amounts less than $1,000.

21. However, there are situations where similar loans can be obtained from the two different types of lenders. For example, one finance company offers a $2,000 12-month loan for 12.99%–29.99% p.a. interest, but a high-cost lender charges 120% p.a. for a similar loan.[2]

22. In some cases, the cost difference between finance companies and high-cost lenders is less than it appears, due to the presence of fees in addition to the interest rate. For instance, one lender appears to offer loans as small as $200 for a term of only three months at up to 29.95% p.a. interest. However, its loan application fee for such a loan is $100. This means that the 'equivalent interest rate' including fees for this loan would be around 368% (labelled "EIR A" on the chart above).[3]

23. Many mobile traders have no or low explicit interest charges. Instead, it is common for them to generate profit by incorporating high costs of borrowing into the price of the goods, which are then paid in instalments – for example, a $15 tin of fruit salad (normally a few dollars), or a $4,440 iPhone (normally $1,399).

Potential problems caused by high-cost loans

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

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

    a. ***Financial harm from frequent use of high-cost loans.*** In theory, borrowers who regularly use high-cost loans may make substantial payments in interest and fees, reducing their net incomes and wealth, and making them more vulnerable to financial shocks

    b. ***Debt spirals.*** Consumers who default on high-cost loans, or seek loan extensions, can end up with unmanageable debt and in financial hardship, even if the original loan was affordable. This is because, if not paid off quickly, high interest rates and fees can result in the rapid accumulation of the loan amount.

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

26. Repeated loans are a commonly reported problem. We have received reports of lenders offering new loans to borrowers immediately after repayment (or even after default), borrowers confirming subsequent loans by text message and lenders with many loans per

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[2] An establishment fee of $240 for the finance company loan means the cost of credit is higher than first appears from the interest rate alone, but it is still less than half that charged by the high-cost lender.

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

borrower. For example, one lender's borrowers took out an average of nine loans each over a two-year period, with some borrowers taking out up to 36 loans. Some lenders have implemented 'stand down' periods for repeat borrowers to help address these issues.

27. Consumer groups have suggested 'debt spirals' or 'debt traps' are also common problems, where borrowers accumulate interest and fees for long periods following default. In one example shared by a budgeting service, a borrower had a debt of around $9,000 referred to debt collection. Since the referral, they had repaid more than $13,000. The total charges on the account were over $19,000 (of which $12,000 was in interest alone).

28. Default rates (i.e. missed or rearranged payments) from a sample of short-term lenders ranged from 4% through to 65%, with a weighted average of 25%. In this group, 35% of defaulted loans still had an outstanding balance over four months after they were first entered into. To prevent debt spirals, a number of major short-term lenders implement caps, so that interest and fees are not charged for more than two months, or beyond a certain multiple of the original loan value.

29. Uncompetitive rates are likely to stem from information failures and patterns of borrower behaviour which limit the amount of price competition in the industry. We believe there are unlikely to be competition issues related to market structure, excessive barriers to entry or anti-competitive agreements, in light of the following:

    a. There are around 340 active consumer lenders in New Zealand, whose firm size and loan offerings vary widely.

    b. There appear to be low barriers to entry. There is high turn-over in the industry and lenders have noted that new participants have entered the short-term online lending market, thanks to the ease of establishing an online business and falling technology costs.

High-cost lenders are a significant source of irresponsible lending

30. Beyond the harms that may be caused by high-cost lending itself, high-cost lenders appear to be a significant source of irresponsible lending, both in New Zealand and overseas.

31. It is important to note that *all* types of lenders have been found to have granted unsuitable and unaffordable loans from time to time. What's more, a number of major high-cost lenders have stated that they have:

    a. strict eligibility criteria for potential borrowers, which exclude people with low-incomes or who are not in ongoing employment, and comprehensive affordability checks

    b. low rates of default

    c. processes for identifying and preventing repeated use of loans by the same borrower

    d. voluntary policies to limit the accumulation of interest and fees on defaulted loans.

32. However, while not all high-cost lenders are irresponsible, many stakeholders hold a strong view that high-cost lenders are significant source of irresponsible lending. This view is borne out by Commerce Commission complaint statistics, where high-cost lenders made up 24% of Commerce Commission CCCFA complaints in 2016/17. This issue is discussed in the next section, with particular concerns about a lack of robust affordability testing.

33. Some stakeholders, including high-cost lenders, have suggested that high interest rates mean that some unscrupulous lenders can make loans indiscriminately, suffer high default rates, and yet continue to generate a profit. Consumer and industry stakeholders have also suggested that some of these lenders earn a substantial proportion of their revenues from default fees and default interest, rather than the original loan repayments.

34. The nature of their customers may also create an opportunity to profit from irresponsible lending. Some high-cost lenders emphasise that their customers are mostly average New Zealanders, with good jobs and sometimes relatively high incomes, rather than being particularly vulnerable. Nevertheless, high-cost lenders' physical outlets cluster in low-income areas, and high-cost lenders appear to cater to many customers with poor credit records and consequently few alternative sources of credit. It follows that some high-cost lenders have incentives to overlook the unaffordability of the loans, in order to profit from this (otherwise under-served) segment of the borrower market.

35. Consumers in difficult financial circumstances or with low financial literacy may have a preference for quick and easy credit over more onerous and rigorous lending processes. A proportion of consumers who cannot afford credit will deliberately seek out irresponsible lenders, after they are turned down by responsible lenders. Given their circumstances, some of these borrowers are likely to have strong incentives to mislead lenders as to their income and expenses, and are unlikely to complain about irresponsible lending. This can create and foster a dynamic of mutual irresponsibility between lenders and borrowers.

Issue 2: Continued irresponsible lending and other non-compliance

36. From our stakeholder interviews and desk-based research, there appear to be unacceptable rates of non-compliance with a range of CCCFA obligations (particularly the responsible lending obligations and public disclosure requirements introduced in 2015) and this is causing considerable harm to vulnerable borrowers.

37. Consumer groups, regulators, dispute resolution schemes and some lenders have reported:

    a. It is common for some lenders to perform only superficial testing of loan affordability and take income and expense information provided to them by borrowers without proper questioning or verification, even where it is plainly incomplete or incorrect.

A representative example is a lender accepting $50 as weekly food costs, for a family with four children.

b. Subsequent loans may be quickly approved (e.g. following an application by text message) and not subject to further checking of affordability, even nine months after the original loan. These suggest that some lenders are not meeting their obligations to make reasonable inquiries into the affordability of loans.

   One example is the case of a mother receiving a Supported Living benefit for her child, who had previously undergone a No Asset Procedure. Three different lenders gave her credit, and none of them checked whether the client had the means to service her debts. A budget advisor contacted all the lenders to advise that their client had financial difficulties, and specifically requested that no further credit be approved. Despite this information and request from the budgeting adviser, two of the lenders subsequently approved 'top-up' loans.

   In another example a couple, both of whose income was from benefits, had been granted three different credit contracts for a total of $5000. Their food budget was $8.74 per week, but they were incurring $90 a month in bank fees for dishonoured direct debits.[4]

c. There is aggressive advertising of high-cost loans to consumers who have previously repaid them, raising questions about whether some lenders are meeting their requirements to advertise responsibly.

d. Upselling of loans (e.g. borrowers being encouraged to borrow $2,000 when they have applied for $1,000 because they can afford it), and continuing pressure on borrowers who have refused loans, suggesting that some lending is contrary to the borrower's requirements and objectives.

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

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

g. Some lenders are setting high fees and not assessing costs when calculating fees, creating a high risk that their fees are unreasonable.

38. We have relatively little information about the prevalence of problems across particular types of lenders. Consumer stakeholders have identified irresponsible lending across all types of lenders, with their reports and Commerce Commission complaints data suggesting problems are particularly concentrated across finance companies and high-cost lenders.

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[4] These anonymised examples were provided to MBIE by budgeting services.

Credit card lending by banks has also been cited as a source of issues. We have noted allegations of irresponsible mortgage and consumer lending by banks raised in hearings of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, although New Zealand banks have been clear that they apply high standards of responsible lending.

39. Our desk-based lender study found:

    a. 20% of finance company websites failed to disclose their interest rates.

    b. 65% of high-cost lender websites failed to include risk warnings.

    c. Non-English language newspaper advertisements appear to comply with almost no advertising guidance.

40. In some cases these problems may be caused by a lack of clarity of CCCFA obligations, and a lack of understanding by lenders. This aspect is discussed in the next section.

41. However, there are also relatively weak incentives for lenders to comply with some CCCFA obligations. Contributors may include a lack of enforcement (both public enforcement and private enforcement), and ineffective penalties for some misconduct (particularly irresponsible lending).

Lack of clarity about legal obligations, particularly around responsible lending

42. Some lender stakeholders said that, notwithstanding the Responsible Lending Code, there is considerable uncertainty about how to comply with the lender responsibilities, or what is an acceptable standard. Some specific areas stakeholders identified are the requirement to undertake affordability and suitability assessments and to assist the borrower to reach an informed decision, as well as how to satisfy these requirements when providing lending online and when dealing with vulnerable borrowers.

43. Consumer advocates have also expressed concerns that the principles-based nature of the lender responsibilities and Responsible Lending Code makes it difficult to know what is prohibited, and when to complain about conduct to the Commerce Commission or dispute resolution schemes.

44. Some stakeholders have told us that online lending exacerbates these issues.[5] Online issues relating to the Responsible Lending Code are being explored by the Code Advisory Group that provides advice on the Code.

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[5] For example, some lenders have reported that it is unclear what is required to conduct compliant affordability and suitability assessments online, and how to assist the borrower to make an informed decision. There are, however, a number of lenders who provide an end-to-end credit application online, and others have told us that online lending facilitates responsible practices because it makes it easier to convey information to the

45. Issues with a lack of clarity or specificity may be contributing to the non-compliance issues identified above.

Issue 3: Continued predatory behaviour by mobile traders

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

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

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

    a. ***The high cost of purchasing goods with some mobile traders.*** The Commerce Commission's investigation into mobile traders found that many products are sold at prices that are significantly higher than the cash prices for a comparable product purchased from a mainstream retailer.[6] In many cases high costs of borrowing are being incorporated into these prices, rather than being charged explicitly as interest or credit fees. This makes them more difficult to regulate under the CCCFA, and in some cases contracts may fall outside the CCCFA altogether.

    b. ***High-rates of non-compliance with consumer protection requirements.*** In 2014 the Commerce Commission investigated 32 mobile trading businesses. The Commission reported that 31 of the 32 businesses visited did not, to varying extents, comply with all of their obligations under the CCCFA and FTA. Following the report, 29 were issued with compliance advice. To date, 13 have been prosecuted for CCCFA and FTA breaches.

    c. ***Predatory and irresponsible behaviour.*** The Commerce Commission confirmed the existence of the following, among some, often smaller mobile traders:

        i. using terms in contracts to ensure continued payment such as obtaining multiple signed direct debit forms

        ii. having obscure terms in the contract that mean that customer payments continue after the item is fully paid, to build an account credit

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borrower in a timely way, and to gather information about the borrower's financial situation (e.g. through bank account transaction analysis services).

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

iii. refund policies which require a home visit (and for which the customer is charged a home visit fee) prior to refund

iv. customers being unable to exercise their statutory or contract rights to cancel their agreements

v. traders failing to make prompt and full refunds

vi. traders retaining the money paid by customers who stop making payments, despite no goods having been supplied to the customer.

49. This behaviour can be considered predatory on the basis of the Commerce Commission's findings that the customers of mobile traders are predominantly located in lower socio-economic communities and that many customers of mobile traders have limited financial literacy and are unable to obtain credit from other sources.[7] These attributes all increase the risk of making poor consumer decisions and make it less likely that people will raise or pursue complaints.

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

Issue 4: Unreasonable fees

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

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

53. The fees requirements put a limit on the fees that can be charged, which varies from lender to lender depending on how their businesses are structured and operate, and the types and levels of the costs they incur.

54. The prohibitions on unreasonable fees have two objectives:

a. ***To protect borrowers from excessive fees***. This is of particular relevance to fees that borrowers may not fully take into account when deciding whether or not to enter into a credit contract. For example, borrowers may not give much consideration to early

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

repayment fees, default fees, payment dishonour fees and other credit fees that they do not anticipate having to pay at the time they sign the agreement.

b. ***To make it easier for borrowers to compare the cost of credit between different providers***. Limiting fees makes it easier for borrowers to compare interest rates, and therefore readily compare the cost of credit, between different sources of credit. Without restrictions on fees, creditors have incentives to reduce their headline interest rates (which are the main point of price competition) and increase mandatory fees (such as loan establishment fees), making it more difficult to ascertain the total cost of borrowing. The unreasonable fees prohibition makes cost of borrowing more transparent and is expected to improve competition in the credit markets.

Concerns that many creditors are charging unreasonable fees

55. We have heard a range of concerns about breaches of the prohibitions on unreasonable fees as part of the broader problem of non-compliance. Some lenders are charging fees for a range of activities which appear to be disproportionate to the cost of the activity and are inconsistent with what reasonable costs would be likely to include. For example, some charge disproportionate costs for mailing out letters or phone calls when they contact a borrower who has missed a payment.

56. Although it does not comment on whether fees were reasonable, the Commerce Commission's lender website review found that the median establishment fee for a loan was $275, with 10% of lenders charging $500 or more.[8]

57. As with irresponsible lending, we have little information about types of lenders where there are significant problems with unreasonable fees, and the types of lenders where there are few such issues.

58. We have been told that there are difficulties enforcing the prohibition on unreasonable fees. This includes that:

    a. The burden falls to the Commerce Commission or the borrower to prove that a fee is unreasonable.

    b. There are insufficient penalties to deter some lenders from charging fees which allow them to make a profit.

    c. Some lenders are not conducting and documenting thorough cost calculations, which makes it time-consuming and costly to check whether or not a particular fee is reasonable.

[8] Commerce Commission, *Lender website review report*, June 2018, available at http://www.comcom.govt.nz/the-commission/consumer-reports/lender-website-review-report/.

A lack of clarity about when a fee is unreasonable

59. This is similar to the problem of a lack of clarity about principles-based requirements identified under Issue 2 in respect of affordability assessments and advertising requirements.

60. Although the Supreme Court's judgement in Sportzone/MTF has clarified the fees provisions to some extent, the court noted that the test of 'reasonableness' is imprecise, difficult to apply, and that often a creditor will need to set its fees in circumstances where it may not have precise cost information. Many stakeholders have raised similar issues.

61. The main test for the reasonableness of fees is that they recover costs that are closely relevant to the transactional activity (such as processing a loan application) that they are being charged for. This test is difficult to apply, particularly as it relates to fixed costs, or to staff or assets that perform more than one activity.

62. Some costs are relatively straightforward to classify as closely relevant. For instance, the wages paid to a staff member while processing a loan application can be recovered as part of an establishment fee. There will be complications in that, for example, some loan applications take longer than others, and not all staff members will be paid the same wage; these require judgements to be made about averaging and forecasting of future costs.

63. Other costs are murkier and more difficult to apportion. To what extent are the wages paid to the manager who supervises the staff member processing the loan application closely relevant to the processing of the loan application? It may depend on how much input the manager has into loan processing in the course of the transaction, which may vary greatly from loan to loan. The depreciation or service costs of the computer that the staff member uses to process a loan application is likely to be partially recoverable; but the staff member may work on a range of tasks using the same computer, some related to processing the loan application, and others unrelated.

64. It is also unclear what is required for third-party fees, for example from debt collectors, to be reasonable.

Issue 5: Irresponsible debt collection practices

65. We have heard concerns that debt collection practices frequently include false and misleading claims, harassment, excessive charges and unrealistic payment demands.

66. In this report, the term "debt collection" has been used to refer to all recovery action taken after a consumer defaults on a loan, beyond short-term steps taken to correct missed payments.

67. Debt collection can work in three ways:

a. ***In-house debt collection***: The original creditor may perform debt collection in-house. This is most prevalent in the early stages of debt collection.

b. ***Debt collection agents***: Businesses may act as an outsourced collection agency for creditors.

c. ***Assignee debt collectors***: A debt collection business may buy debt from lenders before pursuing it.

68. In all cases, creditors are subject to the requirements of the CCCFA, and are responsible for the conduct of their agents.

69. Stakeholders have suggested that the use of external debt collectors is increasingly popular. We have heard claims of some high-cost lenders sending up to a third of defaulted loans to debt collectors. We have also heard that there appear to be an increase in the number of debt collection companies operating in New Zealand. These include a number based overseas. Some also appear to be individuals working from home.

70. Data available to date has been sparse. In 2016, around 3% of the value of budgeting service client debts was owed directly to debt collection agencies.[9] Meanwhile a study of 74 Māori Housing New Zealand tenants[10] found that 43% of respondents were at that time being pursued by debt collectors for a portion of their debt.

There are increasing numbers of complaints about debt collection

71. Complaints to the Commerce Commission about debt collection have been steadily rising.

Complaints to the Commerce Commission about debt collection

Year	Complaints under the FTA	Complaints under the CCCFA	Total complaints
2017	99	20	**119**
2016	68	8	**76**
2015	82	10	**92**
2014	59	5	**64**
2013	17	6	**23**
2012	21	5	**26**

72. It is unclear whether the rise in complaints to the Commerce Commission is due to: (a) an increase in the number or use of debt collectors; (b) an increase in undesirable debt collector behaviour, or; (c) because consumers are more willing to complain when they experience an issue.

73. It is likely that debt collection issues are under-reported. We have heard that consumers are reluctant to complain about debt collector behaviour or irresponsible lending for a

[9] Budgeting service data cited in the Commerce Commission's 2016 Consumer Issues Report.
[10] Survey carried out by a Whānau Ora provider.

range of reasons, including shame, fear, or a lack of knowledge of rights and processes surrounding complaints.

False and misleading claims

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

Unaffordable repayment schedules

75. We have heard that it is common for debt collectors to make unaffordable repayment demands. We think this might disproportionately affect vulnerable consumers, who have limited knowledge and resources to negotiate and advocate for themselves. In one example, a borrower offered the maximum of what they could afford to pay (approximately $120 per month in repayments); the debt collector refused and demanded that double that be paid.[11] Unaffordable repayment schedules create unnecessary additional stress and can cause or deepen in hardship.

76. We've also heard that many debt collectors send initial letters to borrowers that demand immediate full and final payment of the debt. In cases where the borrower has been unable to make smaller instalments to repay the debt, this approach would significantly increase stress on borrowers in hardship, for no appreciable result or benefit to the creditor.

77. In some cases, wage deductions are used to obtain repayments, and we have been told that this practice may be increasing. This is problematic for people in hardship because it means that borrowers' incomes go towards debt repayments before essential items like food and bills. When they have limited income, this can also increase the probability of defaulting on a bill, thereby perpetuating debt spirals.

Excessive charges (fees and interest) for debt collection

78. We've been told that many debt collectors charge borrowers excessively high fees to collect loans. Examples we've heard of include a $30 letter fee incurred when the debt is initially passed on to the debt collector, $15 being charged per phone call, a monthly "arrangement fee" of $5 for the term of the repayments, and a $1 transaction fee per payment.

[11] Anonymised example provided by a consumer advocate.

79. In some cases, total collection costs are bigger than the initial loan. In one example, the charges on an account were 113% more than the original amount referred to the debt collection agency.[12]

80. Incurring additional costs is a reasonable consequence of not repaying a loan in the time agreed, and is a good way of motivating prompt payment. However costs this high may be seen as disproportionate and punitive. Such costs can create debt spirals, trapping individuals into many years of repayments, and perpetuating hardship.

Harassment

81. Stakeholders have raised concerns about unlawful harassment being used by some debt collectors as part of normal business practice.

82. The Commerce Commission's 2016 consumer issues report noted that there are growing numbers of complaints in this area.

83. Examples of harassment include:

   a. Frequent phone calls to the borrower or their employer. We understand that this is very common. We were told of a debt collector who called a borrower's workplace receptionist up to five times a day demanding payment.

   b. Aggressive or coercive behaviour.

84. We have heard that even after a repayment schedule is agreed, some debt collection agencies call borrowers frequently – whether or not the arrangement is being complied with – requesting them to either raise the repayment amount or repay the full outstanding amount immediately.

Resulting consumer harm

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

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

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

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[12] Anonymised example provided by a consumer advocate.

3 Options analysis

89. This section provides further information about the options in the discussion paper. This includes further detail about the design of the options, overseas comparisons, the costs and benefits of the options, and the evidence that supports our assessment of these costs and benefits.

90. In many cases this evidence is highly incomplete and neither the discussion paper nor this report has sought to develop potential packages of options to subject to a full regulatory assessment. These will be developed following the consideration of submissions.

91. In the interim, we have sought to identify the following for each option, under the headings of costs and benefits:

    a. the extent to which the option (on its own) will address the problem

    b. the specific impacts on lenders and borrowers that contribute to the option addressing the problem

    c. other impacts on borrowers, lenders and the credit markets.

3.1 Options for addressing high interest and fees

92. Currently there are no limits on the interest that lenders can charge, but the CCCFA does require that fees must be cost-based. Interest refers to a charge that accrues over time and is determined by applying a rate. Fees comprise all other charges.

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

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

    a. Cap Option A: limit the accumulation of interest and fees

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

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

95. These options are alternatives. Only one (or none) could be adopted, although Cap Option B is an extension of Cap Option A.

96. Below we set out the various options in detail, along with our assessment of their costs and benefits.

Cap Option A: limit the accumulation of interest and fees

97. As discussed above, a key problem with high interest rates and fees is that consumers who default on high-cost loans, or seek loan extensions, can end up with unmanageable debt and in financial hardship, even if the original loan was affordable. High interest rates and fees result in the rapid accumulation of the loans, if they are not paid off quickly.

98. Under Option A, interest and fees over the life of the loan would be limited to 100% of the original loan principal. This means that the borrower would repay no more than twice the original loan principal.

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

100. A similar restriction applies in the United Kingdom (since January 2015) and Australia (since July 2013), and some providers of high-cost loans in New Zealand also apply a similar limit voluntarily. There are also some providers in New Zealand who limit interest and fees on some other basis – for example, interest might not be charged beyond 60 days, which has a roughly similar effect. Limits on the accumulation of interest and fees are also applied on a case-by-case basis by the courts, where a debt is being enforced, and the lack of such limits may result in the credit contract being reopened as "oppressive".[13]

101. The limit would apply to interest and fees on both the original loan, and any subsequent loans provided by the same lender that are used to repay the original loan. This prevents lenders from simply replacing the original loan with a new loan and continuing to charge interest and fees.

Benefits of Cap Option A

102. This option would limit the extent to which borrowers accumulate large debts from a single loan. We would expect that fewer borrowers, particularly the more vulnerable borrowers, would accumulate unmanaged debt and get into financial hardship. Borrowers would pay less in interest and fees overall.

103. We have limited information about the number of borrowers who would benefit, and the extent of those benefits. A significant portion (probably a majority) of the high-cost lending industry by market share already applies a limit similar to that proposed under this option.

104. This option would limit the amount of revenue that affected lenders receive from default interest and default fees, which would make business models based predominantly on

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[13] Part 5 of the CCCFA. The rule of thumb applied by the courts is that default interest cannot be charged beyond a year (Real Finance Limited v Tofi Setefano CIV-2015-096-000094 [2017] NZDC 27629).

these charges less profitable. This may cause these lenders to alter their business models to reduce default rates, so that they may make fewer unaffordable loans.

105. This would have indirect benefits for consumers through reduced financial hardship.

Costs of Cap Option A

106. Some high-cost lenders would lose revenue from interest and fees paid by defaulting borrowers. This option would affect high-cost lenders who do not currently apply limits on the accumulation of interest and fees, or who apply limits that are less restrictive in some circumstances.

107. This option would limit the offering of loan extensions. This may result in borrowers to instead seek a new loan from a different lender, and use it to repay the original loan.

Potential extensions

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

109. A further step could be a prohibition on offering a high-cost loan to a person who has defaulted on an existing high-cost loan (or a loan that refinances that loan), and has not yet repaid it.

110. Going further still, there could be a limit of one high-cost loan per borrower, and a 'cooling-off' period between repayment of a high-cost loan and obtaining a new high-cost loan. The cooling off period could be, for example, 30–90 days, and would apply to new loans from the same lender or a different lender.

111. There are a number of overseas examples of similar cooling-off provisions.

112. The US Bureau of Consumer Financial Protection's short-term loan rule provides that a lender is prohibited from making a short-term loan to a consumer who has already taken out three short-term loans within 30 days of each other, for 30 days after the third loan is no longer outstanding. [14]

113. Individual US states commonly limit the number of high-cost loans or provide for 'cooling-off' periods between successive loans. For example, California, Florida, Hawaii, Ohio, South Carolina and Virginia limit borrowers to one loan at a time.

114. These extensions could cause borrowers to pursue alternatives to another high-cost loan. On the other hand, there is a significant risk that this may exclude some people from

[14] Bureau of Consumer Financial Protection, 12 CFR Part 1041, "Payday, Vehicle Title, and Certain High-Cost Installment Loans".

accessing credit when they need it because of their lending history, or cause them to use less scrupulous lenders who do not check for evidence of other loans.

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

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

116. Under Option B:

a. Interest and fees would be limited to 200–300% per annum. This limit could be expressed as an "equivalent interest rate" that aggregates interest and fees[15], or through separate caps on interest and fees (see discussion below).

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

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

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

Overseas examples of this type of price cap

118. This option is similar to that used in the United Kingdom since 2015. In the UK there is a cap of 0.8% per day in interest and fees (an equivalent interest rate of 292%[16]), a cap on default fees of £15, and total interest and fees are capped at 100% of loan principal over the life of the loan. The UK rules apply to lenders with an annual percentage rate (APR) exceeding 100% per annum.

119. The US states of Maine, Oregon and Colorado cap interest and fees at a roughly similar level.

120. Australia provides that for small loans (<$2,000), costs of borrowing are restricted to a 20% establishment fee and 4% monthly account fee.[17] The minimum term is 16 days. This gives a rather high equivalent interest rate of around 850% for a 16-day loan[18], or 400% for a 28-day loan. Like the UK, there is a cap on total costs of borrowing of 100% of loan principal.

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[15] See footnote 3 for the definition of "equivalent interest rate" used throughout this paper.

[16] Daily rates are converted into annual rates based on the formula, `[annual rate] = [daily rate] × 365`. The UK annual percentage rate (APR) calculation, based on different assumptions, gives an APR for some high-cost lenders of >1500%. See footnote 3.

[17] Larger loans are subject to a 48% interest rate cap.

[18] Based on three equal payments on days 3, 10 and 17 and daily (but not compounding) interest. The equivalent interest rate with daily compounding interest would be around 750%.

For beneficiaries, there is a cap on repayments of 20% of income. These caps apply to lenders other than banks and non-bank deposit-taking institutions.

121. The various Canadian provinces (other than Quebec and Newfoundland and Labrador, which prohibit high-cost lending) have caps similar to those in Australia, with caps on the cost of borrowing ranging from 15% for Alberta, Ontario and New Brunswick, through to 25% in Nova Scotia and Prince Edward Island.

Equivalent interest rate vs separate caps on interest and fees

122. We would welcome views on the best mechanism to cap the rate at which charges are applied, if Cap Option B were adopted. There are three main ways to cap the rate at which charges are applied to loans:

    a. A cap on the annual interest rate – this is not preferred, as it would create strong incentives for lenders to increase fees to compensate, and these are unlikely to be sufficiently constrained by the CCCFA's prohibition on unreasonable fees.

    b. Separate caps on the annual interest rate, establishment fees and ongoing account maintenance fees.

    c. A cap on the equivalent interest rate (this is proposed in Option B).

123. Implementing an interest rate cap that focusses only on the annual interest rate would create strong incentives for affected lenders to increase fees to circumvent it. This is because interest rates and fees both add to the cost of borrowing, and are interchangeable to some extent. For example, a lender who provides a loan of $1,000 for six months earns approximately the same revenue from a 140% p.a. interest rate with no establishment fee, as a 30% p.a. interest rate with a $300 establishment fee. This creates a significant risk that lenders will respond to an interest rate cap by increasing fees without making the overall cost of credit cheaper.

124. While fees are already limited by the CCCFA, these limits are difficult to enforce in practice. The CCCFA requires that credit fees must not be "unreasonable". The Supreme Court decided in 2016 that this means that they must only seek to recover costs that are closely relevant to the matter to which the fee applies. For example, an establishment fee can only recover the actual costs of establishing the loan, such as the wages of the person who processes the application. However, there will always be some ambiguity around the boundaries of what costs are allowed and not allowed to be charged to particular fees. The Commerce Commission needs to conduct complex, resource intensive investigations to show that particular fees exceed costs, and it is virtually impossible for consumers to assess this.

125. Any cap on the annual interest rate therefore needs to address the incentives for lenders to simply increase fees to compensate for reduced interest charges.

126. Possible approaches here are to:

a. provide separate caps on fees. For example, establishment fees could be capped to a certain dollar or percentage amount and other fees (apart from default fees) prohibited.

b. provide a cap on the equivalent interest rate. This applies a formula that takes into account both the annual interest rate and any mandatory fees.

127. The cap in Option B is presented as an equivalent interest rate cap of 200%–300%, but an alternative would be to provide separate caps on both interest and fees. A roughly similar cap could be along the lines of: establishment fee $10; annual interest rate 180%; other mandatory fees prohibited; minimum term 14 days. This would give equivalent interest rates of approximately 190% for a $2,000 loan over 28 days; 250% for a $500 loan over 15 days and 360% for a $200 loan of 15 days.

Separate caps on the annual interest rate and fees

128. A separate cap on fees has the advantage of simplicity and ease of enforcement, but has a number of drawbacks:

a. A fee cap provides less flexibility for lenders as to how their fees are structured. It has been argued that fee flexibility promotes more efficient lending services. If the fee cap is relatively low, lenders will be forced to recover more revenue from interest rates.

b. If a fee cap is relatively high (to allow more lenders to recover fixed costs in short-term loans), or is expressed as a percentage of the loan principal, there is a risk that a fee cap may undermine the prohibition on unreasonable fees. It may give the impression or endorsement that the cap provides a 'reasonable' level of fees – which will not be the case if the lender's actual costs are lower than the cap. Having separate interest and fee caps may disadvantage lenders with low loan establishment costs, as their establishment fees and overall revenue will be more restricted than lenders with high loan establishment costs.

c. If a fee cap is expressed in dollar terms, unless it is very low, it may permit high equivalent interest rates for loans of small principal amounts over short terms. For example, an establishment fee of $30 on a $200 loan over 14 days is equivalent to charging approximately 516% interest per annum. Any separate interest rate that is charged will add to this figure.

Equivalent interest rate cap

129. An equivalent interest rate cap preserves some flexibility for lenders, but the calculation can be complex in some circumstances (e.g. different approaches to compounding interest, variable payments, or fees charged part-way through a loan). This means it may be less obvious when the cap has been breached. New Zealand abandoned disclosure of the annual finance rate (similar to an equivalent interest rate) when the CCCFA was passed

in 2003 due, in part, to complexities and difficulties in the calculation and disclosure of such rates.

Benefits of Cap Option B

130. Based on overseas experience, we would expect the interest rate cap to be largely complied with by lenders, and therefore borrowers using high-cost lending services would pay substantially less in interest and fees. This should contribute to lower rates of default and reduced hardship as a result of high-cost lending.

131. In Australia, the Australian Securities and Investments Commission (ASIC) reported that industry has a good understanding of the caps and appears to be applying it in accordance with the legislation. Only one lender was identified as not charging the correct amount.[19]

132. The UK's Financial Conduct Authority (FCA) has recently evaluated its similar interest rate cap and found a number of benefits to borrowers.[20] It found that consumers are now paying less, repay on time more often and are less likely to need help with high-cost credit from debt charities. Debt charities have also indicated that consumers are presenting themselves earlier and with lower debts, suggesting that underlying problems are being addressed sooner.

Costs of Cap Option B

133. Costs include closures of high-cost lenders, and the possibility that the cap may harm some borrowers, facilitate price coordination and increase illegal lending.

134. Depending on the level of the cap, many high-cost lenders may close. In the UK, the FCA reports that the high-cost lending market has become much smaller since 2015, and that there has been a growth in firms offering longer term loans. Australia has also seen a reduction in the number of high-cost lenders since its cap was introduced, and other lenders have instead 'migrated' customers onto larger, longer term loans.

135. Some harm (though less than Cap Option C) may be caused to borrowers with genuinely short-term cash flow difficulties, as lenders close and tighten lending criteria or offer less short-term loans. However, the FCA reports that it has no evidence that consumers who have not been able to get high-cost short-term loans since the cap have generally experienced negative consequences as a result. They note that the majority (63%) of surveyed consumers who were turned down for these products believe that they are better off as a result (although 28% felt they would have been better off with the loan).

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[19] Australian Securities & Investment Commission, *Payday lenders and the new small amount lending provisions*, Report 426, March 2015, available from http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf

[20] Financial Conduct Authority, *High-cost credit including review of the high-cost short-term credit price cap*, Feedback Statement FS17/2, July 2017, available from https://www.fca.org.uk/publication/feedback/fs17-02.pdf.

Few declined users reported specific negative outcomes like missing bills or cutting back on food (3%).

136. It is possible that the cap could facilitate price coordination, leading some high-cost lenders to raise interest rates up to the level of the cap. This is more likely to occur if the cap is set relatively high (to ensure that high-cost lenders stay in business) and has been observed when a cap at a roughly similar level was implemented in the U.S. state of Colorado in 2000.[21]

137. It is possible that the cap could increase illegal lending (from lenders charging higher interest rates), resulting in weaker protections for borrowers using these services. We think this is less likely to be a serious problem than with Cap Option C, as we would expect the vast majority of high-cost lenders to comply and compliant lenders to provide strong competition against non-compliant lenders. The UK FCA reports that it has "found no evidence that consumers who have been turned down for high-cost short-term loans are more likely to have subsequently used illegal money lenders".

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

138. This option would aim to eliminate high interest rates and fees generally. In doing so, it would seek to address all of the problems related to high-cost lending discussed above, as well as some of the non-compliance discussed as part of Issue 2.

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

140. Such an interest rate cap would effectively prohibit payday lending and other commercial short-term lending of relatively small amounts of money. This is because this lending has high fixed costs that, when converted to an annual rate, appear to inevitably result in triple-digit interest rates. To illustrate the dramatic reduction in potential revenues: a four-week loan of $300 might currently earn a high-cost lender over $120 in interest and fees. With a 50% equivalent interest rate, this revenue would shrink to $7.23. At 30% it would be only $4.33.

141. It would also affect a broader range of lending by finance companies where the term is relatively short (e.g. under 12 months) and there are high establishment fees, and potentially some bank products (such as unarranged overdrafts).

[21] DeYoung, Robert & Phillips, "Payday Loan Pricing", 14 January 2009, Networks Financial Institute 2006-WP-05 (revised version); FRB of Kansas City Paper No. RWP 09-07, available at SSRN: https://ssrn.com/abstract=1066761 or http://dx.doi.org/10.2139/ssrn.1066761

Comparable overseas interest rate caps

142. In the United States, 18 states prohibit payday lending or set low interest and fee caps that effectively prohibit payday lending. For example, New York caps interest and fees at 25% p.a., New Jersey 30% p.a., Montana & South Dakota 36% p.a.

143. The Canadian province of Quebec similarly caps interest rates and fees at 35% p.a.

Benefits of Cap Option C

144. The main benefit of Cap Option C is greatly reducing hardship caused by high-cost lending. This hardship is associated with the high costs of borrowing (interest and fees) and a large and growing debt burden due to repeated use of these products. This may be particularly acute where borrowers underestimate the burden of repayments, or fail to adequately consider the consequences of borrowing.

145. As high-cost lenders are a significant source of irresponsible lending, Cap Option C would be expected to reduce levels of irresponsible lending.

146. There is some empirical evidence that eliminating high-cost lending can be beneficial overall. In particular, there is a body of evidence from the United States (where these types of interest rate caps are common) that associates access to short-term, high-cost lending with significant overall harm. For example, the work of Brian Melzer, an economist at the Federal Reserve Bank of Chicago, has found that greater access to payday loans is, on average, associated with increased difficulty paying essential bills (such as rent, utilities and medical care) – contrary to claims that high-cost lending alleviates such difficulties.[22]

147. The amount of benefit from this option depends, in part, on the extent of non-compliance with current responsible lending requirements. If responsible lending requirements were fully effective (i.e. all high-cost lending was suitable and affordable) there would be less benefit from eliminating high-cost lending through an interest rate cap.

Costs of Cap Option C

148. The main cost of Cap Option C arises from harm to persons with genuinely short-term cash flow difficulties.

149. There are some U.S. studies that show detriments from restricting access to high-cost lending, particularly where households are subject to short-term shocks. For example, recent work by Christine Dobridge of the U.S. Federal Reserve Board compared the effects of access to payday lending in 'normal' times, to the effects after extreme weather events like hurricanes and blizzards when incomes may temporarily drop, and unexpected

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[22] Melzer, Brian T., "The Real Costs of Credit Access: Evidence from the Payday Lending Market", *The Quarterly Journal of Economics*, Volume 126, Issue 1, 1 February 2011, Pages 517–555, available from https://doi.org/10.1093/qje/qjq009.

expenses are incurred.[23] Like Brian Melzer, she found that households are, overall, harmed by access to payday lending in normal times. But after extreme weather events, payday loan access appeared to help borrowers maintain food, mortgage and home repair expenses. This result suggests that such lending can be beneficial where households use high-cost lending to address genuinely short-term cash flow problems.

150. In a New Zealand context, the level of detriment from this option would depend, in part, on the accessibility of other sources of small grants or loans to meet short-term needs – for example, through Work and Income and social lending providers.

151. Other costs of an interest rate cap that prohibits high-cost lending include:

  a. The closure of high-cost lending businesses. Through our desk-based lender study, we have identified 35 such lenders advertising in New Zealand. Some may alter their business models to offer much longer term loans, although we would expect many may cease providing loans altogether.

  b. The possibility that the cap may facilitate price coordination, leading some mainstream finance companies to raise interest rates up to the level of the cap. We are not aware of this having been an issue with similar caps overseas (unlike Cap Option B).

  c. The possibility that the cap may increase illegal lending, resulting in weaker protections for borrowers using these services.

152. On the information available to us presently, we are uncertain about whether Cap Option C would be beneficial overall in New Zealand. It would likely be detrimental for some individuals and families.

3.2 Options for increasing lender registration requirements

153. Currently all lenders are required to be registered on the Financial Service Providers Register (FSPR) under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

154. Registration means that a lender has satisfied certain requirements, including not having been convicted in the last five years of crimes involving dishonesty and not being an undischarged bankrupt. Registration on the FSPR also requires lenders to be a member of an approved dispute resolution scheme so as to provide consumers easier access to redress.

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[23] Dobridge, Christine L., "For Better and for Worse? Effects of Access to High-Cost Consumer Credit," July 2016, Finance and Economics Discussion Series 2016-056, Board of Governors of the Federal Reserve System, available from http://dx.doi.org/10.17016/FEDS.2016.056.

155. This is a low barrier to registration and entry. Registration on the FSPR does not require lenders to demonstrate their knowledge of the CCCFA and the Code, or their plans for how to comply. There is a concern that aside from the basic checks and director disqualifications, the FSPR registration requirement does not adequately prevent entry into the lending market by people likely to become predatory or irresponsible lenders.

156. As regards de-registration, section 108 of the CCCFA currently enables the District Court to order a person not to provide consumer credit, act as a director or take part in management of a company providing consumer credit, or be employed by a lender.

157. The order can be made if the person meets criteria, such as being convicted of an offence, or having failed more than once to comply with any of the provisions of the CCCFA. The Court must also be satisfied that the person is not a fit and proper person to be a consumer credit provider. The Court cannot make the order if it would be out of proportion to the gravity of the offence or misconduct in question.

158. We understand that it has proven resource intensive and difficult in practice to obtain banning orders for lenders and their directors and senior managers.

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

159. Under this option the powers of the Commerce Commission could be expanded to include directing permanent deregistration of lenders. The option also aims to improve the ability of the Commerce Commission to ban directors and senior managers of lenders which have contravened the Act, from future involvement in the industry.

Expand the Commission’s powers to include ordering deregistration of lenders

160. The Commerce Commission could be empowered to direct the Companies Office (as the Registrar of the FSPR) to deregister a lender providing consumer credit if it is satisfied that the lender is causing or is likely to cause harm in their lending conduct to consumers in the future. This power would work to reduce harm caused by predatory and irresponsible lending by permanently removing creditors that are currently causing harm from the register and thus from operating in the market.

161. Creditors could be deregistered as providers of any credit under the FSPR. Alternatively they could be deregistered as providers of consumer credit only (this may necessitate changes to the structure of registration categories).

162. In deciding whether a lender is causing or is likely to cause harm to consumers in the future, the Commerce Commission would be required to take into account the following:

   a. whether the lender has been found by a court to have contravened the CCCFA, Fair Trading Act, sections 217 to 265 of the Crimes Act (relating to crimes against property), the Financial Service Providers (Registration and Dispute Resolution) Act or the Secondhand Dealers and Pawnbrokers Act, or any equivalent overseas legislation

b. any actions or steps taken by the lender to improve practices and prevent future contraventions.

Simplify CCCFA banning orders

163. We also heard concerns that the threshold for obtaining a banning order against a director or senior manager of a lender may be too high, particularly where the individual has not been shown to have personally breached the Act. This issue arises because generally only the creditor (body corporate) is charged with an offence or a party to civil proceedings, but in practice it is directors and senior managers who are responsible for ensuring that the business complies.

164. The CCCFA section 108(1)(vi) enables banning orders against a director or senior manager of a lender body corporate that has breached legal requirements.

165. However, we understand that there is some doubt about when that section applies. The Commerce Commission has not yet sought a CCCFA banning order against an individual, where they were not personally a party to proceedings. In addition:

a. Section 108 does not expressly allow the District Court to take into account misconduct overseas.

b. Section 108(1)(b) of the CCCFA states that for the court to make an order it must be satisfied the person is not a fit and proper person to enter into consumer credit contracts as a lender. However, directors and principal officers do not enter into consumer credit contracts as lenders – they are merely officers of a company.

166. These features of section 108 may present additional obstacles to the Commission obtaining banning orders against directors and senior managers, and thereby allow senior people who presided over proven misconduct to continue working in lending businesses.

167. Under this option, section 108 would be replaced by a new management banning order power applying to individuals. This would provide that a person can be prohibited from being the director of a lender, or concerned in the management of a creditor,[24] lessor or transferee, if:

a. The following has happened twice or more:

i. the person has contravened the CCCFA, FTA, Commerce Act, sections 217 to 265 of the Crimes Act (relating to crimes against property), the Financial Service Providers (Registration and Dispute Resolution) Act and the Secondhand Dealers and Pawnbrokers Act, or any equivalent overseas legislation, or

[24] This is the word used in the legislation to refer to lenders.

ii. the person has been a director or concerned in the management of a creditor, lessor or transferee who has contravened one of the above laws, and

b. The court is satisfied that the order is necessary to protect the public from the risk that the person or the management of a creditor that person is concerned in, will contravene the CCCFA.

Benefits of Registration Option A

168. This option would enable more effective and streamlined banning of people from the lending industry. This would increase the effectiveness of enforcement, using existing enforcement resources. We would not expect a large amount of additional enforcement given constraints on those resources.

169. More effective and efficient bans on directors and senior managers would also reduce the number of 'phoenix' companies operating as lenders. This would reduce demands on monitoring and enforcement resources over time.

170. The prospect of being held personally accountable through a banning process may also act as an added deterrent to irresponsible lending and other non-compliant practices.

171. The above impacts would lead to a small reduction in irresponsible lending and other non-compliance, and a consequent reduction in consumer harm. Each non-compliant lender may be causing harm to many consumers. The extent to which total consumer harm is reduced will depend on to what extent consumers simply shift to other non-compliant lenders, and the accessibility of alternative, responsible finance.

172. There may be a small cost saving for the regulator, as the deregistration process would not require court proceedings.

173. Unlike the other options relating to lender registration, this proposal does not increase compliance costs on all lenders.

Costs of Registration Option A

174. The option does not directly increase compliance costs on lenders, although it may result in lenders taking a more risk averse approach to lending. As generally compliant lenders and their directors and senior managers would be highly unlikely to be subject to deregistration or banning, we would not expect this option to result in 'over compliance' and associated costs.

175. Banning a larger number of lending companies, directors and senior managers creates a risk that more lenders will operate unregistered or 'underground' where their conduct is less able to be monitored.

176. There may be some concerns about the risk of the Commission inappropriately seeking to deregister lenders. However, the Commission would need to apply the statutory test

before deregistering non-complying lenders, and an appeal to the courts would be available.

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

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

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

179. The test could be based on the fit and proper person test in section 396 of the Financial Markets Conduct Act, in which the regulator must be satisfied that:

> *the applicant's directors, senior managers, and proposed directors and senior managers are fit and proper persons to hold their respective positions and otherwise satisfy the requirements that are prescribed by the regulations for license for that service (if any).*

180. The decision of the regulator would be subject to court appeal. Lenders would need to notify the regulator of any changes to directors and senior managers. These persons would also be subject to a fit and proper person test. Costs to government would be recovered through fees.

Individual licensing tests in other jurisdictions

181. In Australia, when assessing whether a person is a fit and proper person to engage in credit activities, ASIC must have regard to any previous licence cancellations, banning orders, criminal convictions, information provided by states or territories and any other relevant matter.[25]

182. The UK currently requires consumer credit providers to be licensed, which includes requiring that persons performing certain 'controlled functions' be approved by the FCA as a fit and proper person to perform those functions. Controlled functions include director functions, compliance oversight and significant management functions.[26]

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[25] Section 37 National Consumer Credit Protection Act 2009 – *When ASIC must grant a licence*
[26] FCA Handbook, SUP 10A: FCA Approved Persons, available at https://www.handbook.fca.org.uk/handbook/SUP/10A.pdf.

183. The main assessment criteria are: the person's honesty, integrity and reputation; competence and capability; and financial soundness.[27] To assess the person's honesty, integrity and reputation, the FCA takes into account, among other things, relevant offences, civil proceedings, other contraventions of regulatory requirements, and investigation or disciplinary proceedings. They also look at the person's history of business insolvencies and whether they have been truthful and candid with the FCA. Competency and capability focus on relevant training and experience. Financial soundness relates to debt judgements and personal insolvency.

Benefits of Registration Option B

184. A fit and proper person test could reduce the participation in the credit markets of individuals who have a history of misconduct, dishonesty or involvement in businesses that show a lack of regard for compliance. This should help to prevent irresponsible lending and non-compliance with the CCCFA.

Costs of Registration Option B

185. This option imposes direct costs on some lenders (from higher FSP registration fees) and also indirect administrative costs. The process for appointing new directors or senior managers would be more onerous.

186. Lenders are likely to pass these additional costs onto consumers in some form. Additionally, the greater requirements for operating in the market may reduce the number of credit providers in the market, reducing consumer choice and potentially lessening competition.

187. It is also possible that some lenders who do not meet the new requirements will operate unregistered, and may be more difficult to identify and monitor.

Licensing agency

188. A number of regulators could potentially administer a fit and proper person test for operating as a consumer credit provider. These include the Commerce Commission, the Financial Markets Authority (FMA), or the Ministry of Justice Licensing Authority. The FMA and Licensing Authority have experience with licensing for specific services. However, the Commission is the regulator responsible for consumer credit and would gain significant market intelligence benefits from administering the fit and proper person requirements.

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[27] FCA Handbook, FIT: The Fit and Proper test for Approved Persons, available at https://www.handbook.fca.org.uk/handbook/FIT.pdf.

Registration Option C: a comprehensive creditor licensing system

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

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

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

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

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

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

192. Lenders would need to notify the regulator of any changes to directors and senior managers, any change that adversely affects its capacity to perform the service, or any change that means it no longer meets the licencing criteria. Creditors may be required to report regularly with information requested by the regulator.

193. The regulator would also have a number of supervisory powers to deal with contraventions or other concerns about the activities and capability of the licensee. These may be along the lines of those available to the FMA under the Financial Markets Conduct Act, such as:

    a. requiring the creditor to submit an action plan setting out the steps it will take to ensure compliance

    b. giving a direction to the creditor

    c. imposing additional conditions of licence

    d. suspending or cancelling the license.

194. Licensing costs to government would be recovered through fees. These would be subject to protections for licensees such as notice periods and statutory criteria for application.

Licensing tests in other jurisdictions

195. In the UK, to apply to the FCA for consumer credit authorisation an entity must satisfy the FCA that they will meet any relevant threshold conditions. These threshold conditions currently require that[28]:

    a. The firm must be capable of being effectively supervised by the FCA (COND 2.3)

    b. The resources of the firm must be appropriate in relation to the regulated activities that it carries on or seeks to carry on (COND 2.4)

    c. The firm must be a fit and proper person (COND 2.5)

    d. The firm's business model must be suitable for a person carrying on the regulated activities that the firm carries on or seeks to carry on (COND 2.7).

196. In addition, persons performing controlled functions within a firm must be approved by FCA (see discussion of fit and proper person test above).

197. The Australian creditor licensing system provides that ASIC must not grant the person a licence unless:

    a. ASIC has no reason to believe that the person is likely to contravene the obligations that will apply if the licence is granted

    b. ASIC has no reason to believe that the person is not a fit and proper person to engage in credit activities

    c. the person has given ASIC any additional information or audit report requested by ASIC

    d. the person meets any other requirements prescribed by the regulations.

Lenders to which licensing would apply

198. A licensing regime could apply to:

    a. all lenders

    b. all lenders, but exclude particular types of lenders (such as banks and credit unions) where there are fewer concerns

    c. only apply to lenders where there are the greatest concerns (e.g. finance companies, high-cost lenders and mobile traders).

[28] FCA Handbook, COND 2.3 – 2.7: COND 2 The threshold conditions, available at https://www.handbook.fca.org.uk/handbook/COND/2/?view=chapter

Benefits of Registration Option C

199. Creditor licensing would have four main benefits:

   a. Licensing would reduce the number of creditors entering the industry who are unlikely to comply with the CCCFA. As with Option B, the requirement would reduce the participation in the credit markets of individuals with prior misconduct. In addition, requiring lenders to demonstrate systems and processes for compliance with the CCCFA means that they could be more likely to understand their CCCFA obligations and to implement processes for complying with them.

   b. Lenders who are generally compliant are likely to adopt more robust systems and processes for ensuring ongoing compliance. Licensees under similar regimes, like the Financial Markets Conduct Act, have reported that licensing resulted in them adopting much more robust compliance systems. This is likely to lead to higher levels of ongoing compliance.

   c. Lender licensing would facilitate more effective monitoring of the consumer credit industry, making it more likely that non-compliance is detected.

   d. Lender licensing would provide more flexible and ongoing means of addressing non-compliance – for example, changes to licence conditions, action plans and directions.

200. Overall, Registration Option C could result in a bigger reduction in irresponsible lending and non-compliance than Registration Options A and B, however the level of this impact is difficult to estimate.

Costs of Registration Option C

201. Licensing would impose significant direct and indirect compliance costs on affected lenders. Direct compliance costs would include initial and ongoing licensing fees. Currently minimum fees for market services licences under the FMC Act range from $2,139 to $10,695, depending on the type of licence. An additional fee may be charged at the FMA hourly rate, where the assessment takes longer than is standard due to the quality or complexity of the application. Taking the mid-point of standard application costs, and assuming 340 lenders offering consumer credit contracts, total initial licensing costs on business could be around $2.2 million. Ongoing costs for renewing licences may also be significant.

202. Indirect compliance costs, such as the administrative burden of meeting licensing requirements, are likely to be larger than the direct cost of fees. Even for firms that are largely compliant with the CCCFA, investment may be required in systems and processes to ensure ongoing compliance. There will also be costs in preparing licence applications (including documenting compliance systems) and meeting any ongoing reporting requirements.

203. It is also possible that some lenders who cannot meet the licensing requirements will operate unregistered, and will be more difficult to identify.

204. While we would expect that expenses incurred by government agencies to administer licensing would be recovered by fees charged on licensing, ongoing monitoring and supervision of licensees would be likely to require further Crown or levy funding. The amount of additional funding required has not yet been determined.

205. Overall, the costs of Registration Option C would be significantly higher than under Registration Options A and B. These various costs may be passed on to borrowers through higher interest rates.

Licensing agency

206. Registration Option C has significant implications for the administration and enforcement of the CCCFA.

207. We consider that, given the links between licensing, supervision and other regulatory activities such as advocacy and enforcement, all these activities would likely be located in a single agency. This would ensure that:

    a. Guidance issued by the licensing agency regarding compliance with the CCCFA is consistent with guidance issued by the enforcement agency.

    b. The licensing agency makes decisions based on information known to the enforcement agency, and the enforcement agency has appropriate access to information from the licensing and supervision process.

    c. Non-compliance can be effectively addressed using the appropriate licensing or enforcement tool. It is important that non-compliance doesn't 'fall through the gaps' between regulators, or result in conflicting regulatory responses.

208. If Registration Option C were adopted, further work would need to be undertaken on the appropriate agency to perform these functions. Two options for the regulatory agency are the Commerce Commission or the Financial Markets Authority:

    a. The Commerce Commission already enforces the CCCFA and has considerable expertise on consumer credit matters. However, the Commission currently does not administer or carry out any licensing functions. This option would require setting up substantial new licensing and supervision systems, staff and processes. This may also require a shift in the approach that the Commerce Commission takes to regulating credit to reflect a 'supervisory' model.

    b. Alternatively, the FMA has regulatory capability and systems for licensing and supervising financial markets participants, and possesses expertise in other areas of the financial sector. However, this would require enforcement of the CCCFA to be transferred to FMA. This would be disruptive, and would be a significant expansion of the FMA's advocacy, enforcement, licensing and supervision functions to cover a new and potentially quite different area of work. FMA would be interacting with a significantly wider range of consumers (compared to its current focus on retail investors, who have money to invest), including the most vulnerable consumers on issues such as mobile traders and high-cost lenders. In combining regulation of investment and credit, their scope of operations would be similar to the ASIC or the FCA.

3.3 Options for strengthening enforcement and penalties for irresponsible lending

209. A major theme of feedback received from both industry and consumer stakeholders is that there has been insufficient enforcement of the lender responsibilities. A number of stakeholders have also suggested that there are inadequate incentives for compliance.

Lack of penalties for irresponsible lending

210. Currently there are no penalties for breaches of the lender responsibilities. The courts can order compensation for any loss to borrowers, and issue injunctions, but there are no offences or civil pecuniary penalties. There has not been use of civil pecuniary penalties in New Zealand consumer law, although these are extensively used in other regulatory regimes, as well as under consumer law in Australia.

211. By contrast, for disclosure under the CCCFA, there are offences with significant fines (up to $600,000 for a body corporate), infringement offences and statutory damages. In addition, section 99(1A) prohibits lenders in breach of disclosure requirements from collecting interest and fees, which can result in large liabilities.

212. The lack of penalties means there are relatively weak incentives to comply with the lender responsibilities. This also affects the incentives for the Commerce Commission to take resource-intensive enforcement action.

Lack of enforcement

213. Between the reforms coming into force in June 2015 and February 2018, no warnings, settlements or prosecutions were taken by the Commerce Commission against lenders for breaches of the lender responsibilities. One warning has subsequently been issued to Dealer Finance Limited on 19 March 2018. By contrast, 33 of these enforcement actions have been completed for breaches of other CCCFA provisions over this period – mostly disclosure breaches. This emphasis on breaches of other CCCFA provisions reflects the relative complexity of bringing cases for irresponsible lending, the lack of penalties for irresponsible lending, and the priority placed by the Commerce Commission on taking action quickly to stop harm – particularly in the mobile trader sector over this period.

214. There have also been a large number of CCCFA investigations closed with no further action. This is partly due to the difficulty faced by investigators in retaining the co-operation of complainants, who may be financially dependent on the creditors who have lent to them in breach of the law.

Liability is directed at the creditor and other body corporates

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

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

216. Under this proposal, breaches of lender responsibilities would attract civil pecuniary penalties and statutory damages.

217. Civil pecuniary penalties would provide stronger incentives for creditors to comply with lender responsibilities.

218. Statutory damages would make it easier for borrowers to claim compensation where lender responsibilities were breached.

Level of civil pecuniary penalties

219. We propose that the maximum civil pecuniary penalties would be $200,000 for an individual or $600,000 for a body corporate. This is consistent with the level of fines under section 103, and also the civil pecuniary penalties that apply under the Financial Markets Conduct Act for breach of various duties (e.g. duties of the manager of a managed investment scheme to act in the best interests of scheme participants).

Level of statutory damages

220. Where lending has been made in breach of suitability or affordability requirements, we propose that a standard level of statutory damages would be paid equal to the interest and fees charged. No further interest and fees could be charged on the loan. The court could also order that payment obligations under the credit contract be amended to provide for affordable repayment of the principal amount of the loan.

221. Statutory damages could be reduced under sections 91 and 92 of the CCCFA. This provides that a court can reduce statutory damages if it is just and equitable to do so. The court could take into account a range of factors, such as the reason for the breach, whether a

person has been prejudiced by the breach and whether the lender has an appropriate compliance programme.

Alternative to civil pecuniary penalties of providing criminal offences

222. An alternative to civil pecuniary penalties would be to provide a criminal offence for breach of the lender responsibilities. This would be more consistent with the current scheme of the CCCFA, which uses offences rather than civil pecuniary penalties. Offences have a higher burden of proof ('beyond reasonable doubt') compared to civil pecuniary penalties ('on balance of probabilities'), which is arguably more appropriate before applying a significant financial penalty.

223. There has been a reluctance to attach offences to breaches of some principle-based duties, including the lender responsibilities, as they are less certain than most matters that are criminal offences. However, given that creditors are almost all body corporates, there may be little practical difference in the effect of receiving a conviction and fine compared to a civil pecuniary penalty. Moreover, existing laws such as the Fair Trading Act use offences for relatively uncertain, principles-based standards (such as the prohibition on 'misleading' representations).

Expanded injunctive relief

224. Where lenders have breached the lender responsibilities (or other provisions of the CCCFA), the Commerce Commission can seek an injunction under section 96.

225. However, currently injunctions are restricted to "restraining a person from engaging in conduct" that would breach the CCCFA. This is inapt for the lender responsibilities, which are positive duties on lenders. Injunctions cannot require that lenders undertake any particular steps to achieve compliance with the lender responsibilities. They can only demand that lenders do not breach the lender responsibilities (which are a legal requirement in any case).

226. Under this option, if a lender has breached the CCCFA, or is likely to breach it, the Commerce Commission would be able to seek injunctions for the purpose of ensuring that the lender is compliant with the CCCFA. For example, the court could temporarily prohibit the lender from undertaking further lending, or require that it undertake a review of its compliance and provide a report to the Commerce Commission on the steps it will take (who could consider whether those steps were adequate, and if not, could seek a further injunction).

227. A further step - which we do not propose as part of this option (but would welcome feedback on) - would be to provide the Commerce Commission with "stop order" and "direction order" powers along the lines of those provided in Part 8 of the Financial Markets Conduct Act. These would allow the Commerce Commission itself to order that a person stop lending and specify any reasonable steps it must take in order to comply with the provision or to avoid or mitigate any adverse effects of a contravention.

Benefits of Enforcement Option A

228. Civil pecuniary penalties, statutory damages and injunctive relief would increase incentives for lenders to comply with the lender responsibilities, and would therefore be likely to reduce irresponsible lending. It would do so through three mechanisms:

    a. First, it would create the prospect of a monetary penalty and higher levels of damages for irresponsible lending, which is greater than any compensation due.

    b. Second, civil pecuniary penalties and expanded injunctive relief would make it easier for the Commerce Commission to take cases, and increase the amount of enforcement action taken. The Commission could file civil proceedings without needing to thoroughly review every instance in which a lender may have lent irresponsibly and quantify the specific losses and damage to borrowers; instead they could take cases over a smaller number of identified instances of irresponsible lending, and obtain an injunction or pecuniary penalties. The increase in enforcement action would increase the likelihood that irresponsible lending resulted in enforcement, and further increase incentives to comply.

    c. Third, statutory damages would increase the benefits for borrowers taking action in cases of irresponsible lending. Presently, it is difficult for borrowers to quantify losses, and therefore to claim compensation. We would not expect this effect to be very large, given the reluctance of borrowers to take action against lenders generally (particularly vulnerable borrowers who are dependent on lenders), and the apparent willingness of lenders to settle quickly in any case.

Costs of Enforcement Option A

229. The introduction of civil pecuniary penalties may increase risk aversion among lenders, and therefore compliance costs.

230. Penalties may also make it less likely that the Commerce Commission seeks compensation for borrowers, beyond the level of statutory damages. Civil cases could be taken for penalties and statutory damages only, and it may be more onerous to take a compensation claim, as this requires the Commission to collect information from borrowers about loss. This means that some borrowers may miss out on compensation unless they pursue the lender separately through a follow-on proceeding.

Enforcement Option B: directors’ duties

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

232. Directors could fulfil their duties by ensuring the creditor has adequate policies for compliance with the CCCFA, and adequate systems for implementing those policies and detecting and correcting breaches.

233. Directors with more direct involvement in the day-to-day management of the creditor (e.g. small creditors with a managing director) may fulfil their duties by implementing appropriate systems themselves, ensuring that staff are adequately trained and regularly checking compliance and taking corrective action.

Formulation of directors duties

234. There are a number of ways that a directors' duty could be specified:

a. directors must take reasonable steps to ensure that the creditor complies with its obligations under the CCCFA (as above); or

b. directors must ensure, as far as reasonably practicable, that the creditor complies with its obligations under the CCCFA (similar to duties in the Health and Safety at Work Act 2015); or

c. directors must exercise due diligence to ensure that the creditor complies with its obligations under the CCCFA.

235. Another approach, taken by legislation like the Financial Markets Conduct Act, is to deem directors strictly liable for breaches of legislation by the creditor, and then to provide defences – e.g. if directors can show that they took all reasonable and proper steps to ensure compliance.

Extension to senior managers

236. Another issue is whether duties should only be applied to directors, or should also be applied to senior managers – those whose position allows them to exercise significant influence over the management or administration of the creditor (for example, a chief executive or a chief financial officer). The scope of those duties would be limited by the scope of the person's role.

237. An extension to senior managers may better target duties at persons making important strategic and day-to-day decisions, rather than on directors with broad governance responsibilities.

Benefits of Enforcement Option B

238. Option B would create much stronger incentives for directors to ensure that the creditor complies with its CCCFA obligations.

239. Director liability would also help to address issues with companies in breach being liquidated without payment of penalties and compensation, and then setting up new

'phoenix' companies. Directors who breached their duties would be personally liable for penalties and compensating borrowers.

240. This would be expected to moderately reduce irresponsible lending and non-compliance, and resulting consumer harm.

Costs of Enforcement Option B

241. As with other regulatory regimes with director liability, this proposal raises questions about the effects on incentives to be a director, the price of liability insurance, and promotion of a risk-averse approach to company governance.

242. The possibility of personal liability creates a disincentive for skilled, professional directors to serve on creditor boards. It is unclear how significant this issue is likely to be in practice. Directors, particularly in financial services, have significant personal liability under a variety of laws at present, and many will have insurance in place.

243. This may increase the price of directors' and officers' liability insurance. We would be interested in any information about how the price of this insurance has been affected by previous imposition of directors' duties.

244. It may also promote more risk-averse governance of creditors, with an emphasis (or overemphasis) on risk assessment, implementation of compliance plans, and director sign-off. We understand this has been the experience of some other regimes, such as the Health and Safety at Work Act 2015 – although in that case, directors may be criminally liable with significant fines and potentially imprisonment.

245. Careful consideration would need to be given to the specification of director duties and the defences available to directors.

Enforcement Option C: substantiation obligation for lenders

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

Benefits of Enforcement Option C

247. This option would increase the ability for borrowers, borrower representatives, and the regulator to identify breaches. This could act as a deterrent for non-compliant lenders if they know their practices can be more easily reviewed.

248. It would be likely to increase the proportion of irresponsible lending reported to the Commerce Commission, as borrowers and their advisers would have better information about whether a breach had occurred.

249. Putting the burden of proof on lenders to show that they are making the correct assessments would also make it easier for the Commerce Commission to monitor and investigate non-compliance.

250. Borrowers would also be more likely to obtain compensation from lenders who had lent to them irresponsibly. It would provide the most benefit to borrowers who have access to and the support of budget advisers or community legal advisers, as borrowers themselves may be unaware of their rights regarding affordability assessments.

251. Overall, this option would be expected to increase enforcement of lender responsibilities and lead to a small reduction in irresponsible lending.

Costs of Enforcement Option C

252. This option would create additional compliance costs for lenders who are not currently documenting this aspect of their processes. However, we would expect that most compliant lenders already keep records of this information. Therefore we would expect the compliance cost impacts to be relatively low.

253. There would be some ongoing costs to lenders from responding to requests from the regulator or borrowers to substantiate their affordability and suitability assessments, although we would not expect these requests to be frequent for responsible lenders.

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

254. Enforcement by the Commerce Commission is undertaken under its Crown-funded "Enforcement of General Market Regulation" appropriation – $17.5 million in 2016/17. This is used for administration, education and enforcement of the Commerce Act 1986, the Fair Trading Act 1986, and the CCCFA. From this appropriation, $3.3 million was spent on CCCFA activities in 2016/17.[29]

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

256. Increasing these activities will require more resources and funding. Currently all funding for credit regulation is sourced from the Crown (mostly through general taxation), which has been increasing its contribution.

[29] The costs include CCCFA matters in which there is also an FTA investigation and this activity forms part of the Commerce Commission's general markets and major litigation activity. Historical expenditure includes both direct and overhead costs. Some expenses are fixed, while others are variable costs based on the activity.

257. Creditors (along with a number of other financial service providers) currently pay an annual levy of $460 (plus GST), which helps to fund the Financial Markets Authority.

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

259. An increased industry levy would reflect the fact that both borrowers *and* responsible lenders benefit from well-regulated credit markets. A number of lenders have pointed to examples of a lack of enforcement as creating an ‘uneven playing field’. Funding enforcement and reducing non-compliance would make it easier for compliant businesses to compete fairly.

260. There is a strong precedent for using this model; industry levies fund a significant proportion of the activities of the FMA (another enforcement agency), the XRB, and the Companies Office.

Benefits of Enforcement Option D

261. Additional funding would allow the Commerce Commission to increase its advocacy, monitoring, and enforcement of the CCCFA.

262. This has the potential to significantly reduce levels of non-compliance. This would reduce harm to consumers, and enable lenders to compete on a more level playing field.

Costs of Enforcement Option D

263. Levy funding would impose direct costs on lenders, depending on the level of the levy. Some of these costs may be passed on to borrowers.

264. Some lenders – such as banks – already have a number of different levies that they have to pay.

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

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

Benefits of Enforcement Option E

266. This would reduce the likelihood of consumer harm, as advocates like budget advisors or lawyers are likely to have more detailed knowledge of the CCCFA. This means that they will be able to ensure that it is correctly adhered to. It may also act as a deterrent to irresponsible lending because of the increased likelihood of being caught.

267. It would make business transactions smoother, as they would be able to interact with consumer advocates that had a better understanding of what lenders' rights were. It would therefore lower some costs for businesses.

268. It would make self-enforcement of rights easier, thereby lowering government enforcement costs.

269. It would directly address concerns from consumer advocates that some creditors refuse to engage with them.

Costs of Enforcement Option E

270. Creditors and their agents would likely have to spend more time justifying or verifying their actions. As a result, they would have higher compliance costs.

271. This option assumes that consumers who need advocates are able to access and request them, and that the advocate system has enough capacity to accommodate all requests for help. This is not always the case. As a result, the efficacy of this option may be limited by other issues that are outside the scope of this review.

272. Advocates may be more likely to report breaches of the law to enforcement agencies. This would raise enforcement activity and may result in a net increase in enforcement activity and subsequent costs.

3.4 Options for introducing more prescriptive requirements for affordability assessments and advertising

273. The Responsible Lending Code (the Code) is made under the CCCFA to provide guidance on how to satisfy the responsible lending requirements contained within the CCCFA. The CCCFA provides that evidence of a lender's compliance with the provisions of the Responsible Lending Code is to be treated as evidence of compliance with the lender responsibility principles. The Code is intended to make it easier for lenders to determine what their obligations are and how to meet them.

274. The Code is not binding, meaning that it does not hold lenders to account if they do not behave exactly as specified in the Code's guidance. This is because lenders can satisfy the lender responsibility principles in other ways not explicitly mentioned in the Code.

275. There are significant advantages to principles-based regulation. It can be applied flexibly to a wide range of current and future lending situations. It doesn't rely on regulation anticipating all of the situations in which it will be applied and doesn't require constant revision to deal with new technologies, practices and business models. It also allows regulated parties to develop their own ways to comply with the principles, which may be

more efficient and effective than would be provided for by prescriptive regulation. It provides room for regulated parties to innovate and adapt their businesses and compliance plans, whilst still achieving the aims of the regulatory regime.

276. For all its virtues, an overreliance on principles-based regulation has been identified by stakeholders as contributing to problems described above with non-compliance and a lack of clarity about legal obligations. The responsible lending principles may cause particular issues when applied in isolation to smaller, less sophisticated lenders without a strong compliance culture.

277. These problems are more significant where there is little case law on what is required to meet the lender responsibilities (presently there is no New Zealand case law on responsible lending at all). This means that the guidance that can be given through the Responsible Lending Code, or by the regulator, tends to be limited in order to avoid falling out of step with legal requirements.

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

278. Lenders are currently required to make reasonable affordability inquiries, before entering into a credit contract. This is so that they can be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship.

279. The Responsible Lending Code offers some guidance on how this requirement might be satisfied. For example, it provides that a lender should inquire into a borrower's income (current income, its sources and stability, any intended sale of assets), expenses (necessities such as accommodation, other debts and commitments, other regular expenditure and any likely changes), and the likelihood of repayment (credit history and other information).

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

a. collect the following information from the borrower:

i. a statement of the borrower's net income (after tax and other deductions), financial commitments (mortgage payments, rates, rent, child care and support, payments on any other debts) and living expenses (utilities, food, school fees, clothing, health care, transport, insurance, any other recurring expenses), employment status, the number and age of persons financially dependent on the borrower

    ii. all bank (or non-bank deposit taker) account transactions for the borrower over a minimum period (e.g. 90 days)

    iii. if any source of income is not credited to an account, copies of documents evidencing income from the source of that income (e.g. a letter from employer, pay slips) or Inland Revenue

    iv. for business income, financial statements prepared by an accountant

b. calculate net monthly income based on supporting evidence

c. identify financial commitments from account transactions

d. calculate monthly expenses based on the sum of:

    i. identified and declared financial commitments (take the maximum, if there is any discrepancy)

    ii. the maximum of:

        1. the amounts declared by the borrower for living expenses, or

        2. a minimum allowance for living expenses

    iii. the maximum monthly repayments under the proposed credit contract.

e. require a minimum monthly surplus, after subtracting monthly expenses from net monthly income (e.g. $100)

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

Comparable requirement in Australia

282. In Australia, lenders under small value credit contracts are required to obtain 90 days of account statements. ASIC has reported that payday lenders were aware of this requirement and had adequate systems in place to ensure they received the necessary account statements. However, there were varying levels of consideration of these statements by lenders.

283. Responsibility Option A sets more prescriptive requirements than in Australia for how the lender needs to use the information obtained from transactions.

Ability of lenders to rely on information provided by the borrower

284. Section 9C(7) of the CCCFA provides that for affordability and suitability requirements, “the lender may rely on information provided by the borrower or guarantor unless the lender has reasonable grounds to believe the information is not reliable”. This provision was added following consultation on the exposure draft of the Credit Contracts and

Consumer Finance Amendment Bill in April 2012. Some lenders were concerned about uncertainty about the level of verification necessary.

285. The threshold of "reasonable grounds" is high, and in practice this means that lenders are permitted to accept borrower statements about income and expenses at face value, unless they are inconsistent with other information the lender holds about the borrower, or are unrealistic.[30] This is likely to be a barrier to requiring lenders to undertake reasonable inquiries to assess the affordability of repayments.

286. As part of considering more prescriptive affordability requirements, we are considering whether this provision should be removed, or significantly narrowed. This would mean that lenders would need to obtain more objective verification of key borrower information, where it was warranted as part of undertaking "reasonable inquiries". For example, lenders may need to obtain payslips or bank account transactions to verify income and fixed financial commitments, given that this is among the most important borrower information.

287. Even without section 9C(7) most information provided by the borrower would generally not need to be verified. Whether information needs to be verified as part of reasonable inquiries would depend on:

a. ***The importance of the information to the assessment:*** It is not reasonable to verify information that, if it were inaccurate, would not have a significant impact on the lending decision. This could include, for example, not verifying declared living expenses if there is a sufficient buffer between income and fixed financial commitments to cover reasonable living expenses.

b. ***The costs and difficulty of verifying the information:*** if it is onerous to verify a particular piece of information, it may not be reasonable to do so.

Benefits of Responsibility Option A

288. By specifying particular requirements for affordability assessments, this option makes it easier for borrowers, advisers and the regulator to detect breaches of lender responsibilities.

289. This option would provide greater clarity about what assessments and evidence is required to comply with affordability responsibilities. As well as lenders for which the requirements were mandatory, it may set higher expectations for other lenders about the types of information that may be best to collect, and how the assessment is performed.

290. Both the increased risk of detection and the clearer specification of requirements mean that this option would be likely to improve compliance by some lenders. It would have the largest effect on lenders who genuinely intend to comply, but who do not currently do so

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

due to an inadequate understanding of the principles-based requirements. Improved affordability assessments would lead to less irresponsible lending and resulting hardship.

Costs of Responsibility Option A

291. The costs from this option will depend on the scope of lenders covered, and the precise requirements.

292. Lenders who are currently compliant would incur additional costs to the extent that any new mandatory requirements were inconsistent with their existing practices. These costs may be mitigated through careful design of the requirements to align with current best practice.

Responsibility Option B: introduce more prescriptive requirements for advertising

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

294. Our desk based review of lender websites has found that the Code's guidance on advertising is poorly adhered to by some lenders. For example, risk warnings are rarely used. They were only identified in around 35% of high-cost lender websites.

295. Under this option, the current Responsible Lending Code guidance for advertising would be made binding, with any necessary or desirable modifications.

Benefits of Responsibility Option B

296. This option would be expected to raise the level of compliance with lender responsibilities relating to advertising.

Costs of Responsibility Option B

297. We have heard from lenders that they treat the Responsible Lending Code guidance as if it were mandatory at present. Therefore we would not expect most lenders to need to implement changes to advertising practices as a result of this change. However, there may be changes to some systems and processes of compliant lenders to give them greater confidence about their ongoing compliance with the advertising requirements. Any such changes will involve some costs.

Are further steps on advertising necessary?

298. The actual impact of more responsible advertising (as currently contained in the Responsible Lending Code) is unclear. We did not receive feedback on the benefits of the current Code requirements, although we received a number of concerns about advertising that was seen as 'irresponsible' insofar as it promoted the appeal of debt and implied 'instant gratification'. This is not directly addressed at present by the Responsible Lending Code.

299. Some stakeholders suggested that elements such as risk warnings should be extended beyond high-cost lending to a wider range of credit products, or that advertising for high-cost lending should be prohibited.

300. We would welcome feedback on whether any changes to the advertising provisions of the Responsible Lending Code – whether they remain non-binding or become mandatory – should be considered.

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

301. In some cases, advertising is provided in a language other than English, but the credit contract is provided in English. Borrowers for whom English is not their first language may be vulnerable in this circumstance.

302. The problem is that the advertising in one language targets particular types of vulnerable consumers in an irresponsible way. There is a risk that the requirement to assist the borrower in making an informed decision is not being met for this category of vulnerable consumer.

303. The Responsible Lending Code provides:

Where a lender reasonably suspects that the borrower does not have a good understanding of the English language, a lender should provide, or refer the borrower to, alternative methods or mechanisms for receiving the relevant information. This could involve the lender providing access to, or referring the borrower to, an interpreter or a member of staff who is fluent in the relevant language, or providing access to the information in that particular language. A lender should not rely on children under 18 or those with a potential conflict of interest to act as interpreters; for instance, where a parent is obtaining a loan for an adult child's benefit, the child should not be an interpreter.

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

Benefits of this option

305. Vulnerable consumers would be far more likely to understand disclosure documents under this option. This would assist them in making better informed decisions, which would in turn reduce consumer harm.

306. It would reduce incentives for predatory lending that is targeted at vulnerable consumers who don't understand contractual terms, but are legally bound by them.

307. It would ensure that the level of assistance received by vulnerable consumers would at least match that received by other consumers, thereby ensuring that consumer harm is more broadly and evenly experienced.

308. It would create a more prescriptive understanding of responsible lending obligations around assisting with making informed decisions. This would make enforcement action easier and more targeted. As a result, it would lower relative enforcement costs and increase the deterrent effect of responsible lending legislation.

309. Lenders would have a clearer idea of their responsible lending obligations. This would make compliance easier.

310. The targeted nature of this option (disclosure in the non-English language only being required if there is advertising in that language) means that lenders will not be required to produce disclosure in a cumbersome number of languages. They will only have to provide documentation in the languages they are already engaging with consumers in.

Costs of this option

311. Lenders would have to produce disclosure documents in a number of languages. This would raise their production costs. However, to produce advertisements in languages other than English, they likely already either have access to interpreters or people in their organisation who are fluent in the advertisements' languages. This means that the burden would be reduced.

312. More enforcement action would be required to ensure compliance with new requirements. This would raise enforcement costs.

3.5 Options to address predatory and irresponsible behaviour by mobile traders

313. Many of the options to address issues with mobile traders are the same as for other lenders covered by the CCCFA. In summary these are options for:

    a. increasing creditor registration requirements

    b. strengthening enforcement and penalties for irresponsible lending

c. more prescriptive requirements regarding affordability and advertising

d. options to address unreasonable fees

314. In addition, there are a number of options we discuss below for providing that more mobile traders selling goods on credit are covered by the CCCFA, and enabling any interest rate caps to be applied to mobile traders.

Options to address credit sales falling outside the CCCFA

315. Some mobile traders (and also some other businesses[31]) provide purchase agreements for goods which are received up-front and paid for in instalments, but there are no explicit interest or credit fees and the creditor does not take a security interest.

316. The absence of interest, credit fees or a security interest may mean these do not fall within the definition of 'consumer credit contract'.[32] We are aware of at least two mobile shopping truck operators using these contracts. As noted above, these traders often inflate the price of the goods, so that high costs of borrowing are being incorporated into the price of the goods.

317. If these contracts fall outside the CCCFA, these firms are not required to lend responsibly, make appropriate disclosure or charge reasonable default fees. In the case of inflated prices, consumers may not be aware of the high costs of borrowing they are paying. Additionally, the lenders may not be required to be registered financial service providers under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and may not be members of an approved dispute resolution scheme.

318. We have considered two options for adjusting the scope of the CCCFA:

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

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

319. Both of these options relate to the definition of "consumer credit contract", which is defined in section 11(1) as follows:

[31] For example, Afterpay, Laybuy, PartPay and Oxipay.
[32] Although there is an argument, yet to be tested in New Zealand courts, for there being implicit credit fees on some of these contracts.

(1) A credit contract is a consumer credit contract if—

(a) the debtor is a natural person; and
(b) the credit is to be used, or is intended to be used, wholly or predominantly for personal, domestic, or household purposes; and
(c) 1 or more of the following applies:

(i) interest charges are or may be payable under the contract:
(ii) credit fees are or may be payable under the contract:
(iii) a security interest is or may be taken under the contract; and

(d) when the contract is entered into, 1 or more of the following applies:

(i) the creditor, or one of the creditors, carries on a business of providing credit (whether or not the business is the creditor's only business or the creditor's principal business):
(ii) the creditor, or one of the creditors, makes a practice of providing credit in the course of a business carried on by the creditor:
(iii) the creditor, or one of the creditors, makes a practice of entering into credit contracts in the creditor's own name as creditor on behalf of, or as trustee or nominee for, any other person:
(iv) the contract results from an introduction of one party to another party by a paid adviser or broker.

320. Section 15(1)(a) of the CCCFA then excludes contracts for goods and services that are to be paid off within two months at the agreed price:

(1) The following contracts are not consumer credit contracts:

(a) a contract for the sale of property, or the provision of services, to a person if the total amount payable under the contract by the person (other than any amount payable solely as a result of a default in payment by the person) is the agreed price of the property or services and is to be paid within 2 months from the day the contract is entered into:

321. As discussed above, this definition of 'consumer credit contract' means that some contracts that cause similar consumer issues to consumer credit contracts fall outside the scope of regulation.

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

322. Under this option, default fees would be added to section 11(c), which currently requires that to be a "consumer credit contract", a credit contract must include interest charges, credit fees or security interests.

323. This means that credit contracts with default fees would become regulated under the CCCFA (provided they met the other limbs of section 11). The exception in section 15(1)(a) of the CCCFA would be modified to remove the allowance for default fees.

324. While this would provide consumers with CCCFA protections in a wider range of circumstances, we would be interested in feedback on what contracts would still be excluded by this.

325. We would also be interested in feedback on what types of contracts might be inappropriately captured by this change.

Benefits of Scope Option A

326. This would provide consumers with CCCFA protections in a wider range of circumstances.

327. To the extent that mobile traders continued to charge default fees, a greater number would be captured by the CCCFA, reducing irresponsible and predatory behaviour.

328. Default rates and consumer harm from newly covered credit contracts would be expected to reduce, although it is unclear to what extent this is an issue outside of mobile traders.

Costs of Scope Option A

329. Lenders who were newly captured by the amended definition would face significantly higher compliance costs. It is possible that this could have a significant adverse impact on the business models of recent credit-based payment systems, such as Afterpay, Laybuy, PartPay and Oxipay.

330. Borrowers using newly captured lenders would face longer and more onerous credit application processes.

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

331. Under this option, the CCCFA would prohibit credit sales of personal, household and domestic goods and services where the price of the goods (excluding interest and fees) exceeds the cash price of the goods or services. The cash price would be defined along the lines of the following:

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

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

whichever is the lesser.

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

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

333. The provision for the "fair market value" is to deal with situations where a cash price is either not offered, or unrealistically high cash price is offered that does not reflect the price at which cash transactions take place or would be likely to take place.

334. This option would address the existing uncertainty about whether the difference between the price of goods and the cash price or fair market value is covered by the CCCFA. It is arguable, but has not been tested in the courts in New Zealand, that a difference between the credit price and the cash price may be treated as an implicit "credit fee". In this case, it would likely be an unreasonable credit fee under section 41 of the CCCFA.

Benefits of Scope Option B

335. The benefits of Scope Option B are:

a. Interest rates (potentially quite high interest rates, as in the example above) are much more explicit and transparent.

b. Because interest is charged, the credit contract is classified as a consumer credit contract and captured by the CCCFA.

c. Any interest rate caps (as in Option 1B and 1C), would apply to these contracts.

336. This means that consumers are likely to be better informed and better protected from harm.

Costs of Scope Option B

337. Lenders who have previously been selling goods or services on credit above the cash price would face significantly higher compliance costs, due to the need to comply with the CCCFA.

338. We would be interested in feedback on any situations where consumer goods and services might be sold on credit above the cash price or fair market value, but these should not be considered consumer credit contracts.

3.6 Options for addressing unreasonable fees

339. To address issues with unreasonable fees, we discuss three options:

   a. Fees Option A: require lenders to substantiate reasonableness of fees

   b. Fees Option B: impose specific fee caps in regulation

   c. Fees Option C: return to disclosure and advertising based on an ‘equivalent interest rate’.

340. Below we set out the various options in detail, along with our assessment of their costs and benefits.

Fees Option A: require lenders to substantiate reasonableness of fees

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

Benefits of Fees Option A

342. The prohibition on unreasonable fees would be easier to enforce, and more likely to be enforced. We would expect compliance with fees regulation to improve, as non-compliant fees would be more likely to be detected.

343. This option is likely to benefit consumers to the extent that fewer lenders charge unreasonable fees.

Costs of Fees Option A

344. This option would result in a small increase in compliance costs for lenders, as it would require more careful documentation of fee-setting processes. However, we would expect responsible lenders to be documenting their fee-setting processes for compliance with the existing fees regulation.

Fees Option B: impose specific fee caps in regulation

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

346. Instead of restricting fees to costs, which vary widely between lenders and are difficult to calculate with certainty, this option would prescribe monetary fee caps for different types of mandatory fees, and prohibit other mandatory fees. Prepayment fees would continue to be regulated as at present, and charges for optional services would continue to be unregulated.

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

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

Types of lenders to which fee caps could apply

349. Fee caps could apply across a broad range of loan and fee types, or could be more specifically targeted. As we have little information about the types of lenders where unreasonable fees are a problem, it is unclear what types of lenders fee caps would be most effectively applied to or not applied to.

350. If Cap Option B or Cap Option C were pursued, depending on the structure of the interest and fee caps, high-cost lenders may already be covered by fee caps.

Setting maximum fees

351. A significant challenge for this option would be setting and updating the fee cap. This could be done through regulations or delegated to the Commerce Commission, and would be subject to statutory criteria. Fee caps would need to be updated regularly to reflect inflation.

Benefits of Fees Option B

352. Fees Option B would provide much greater clarity over permitted fee levels, and significant benefits for consumers from improved comparability of credit products and reduced non-compliance with fees regulation.

353. Lenders would have certainty about what fees were considered reasonable. They would no longer need to perform cost calculations for most fees, or deal with difficult apportionment issues in determining which costs are closely connected to specific lending activities.

354. Standard maximum fee levels would mean that consumers could be more confident when comparing credit products by reference to interest rates.

355. Enforcement of the fee caps would be relatively straightforward for both the Commerce Commission and borrowers, especially in comparison to the existing law.

356. There may be additional benefits to consumers from lower fees, although this would depend on the levels of the fee caps compared to current fee levels. These benefits are clearest where lenders are currently charging very high fees, likely in breach of the current law.

Costs of Fees Option B

357. Lenders would lose the ability to charge fees that reflect the actual costs of their various activities. In particular, some fees may no longer be chargeable, if they are not expressly permitted. Lenders and some consumers would lose the benefits that come from fees reflecting actual costs, and some fees may rise to the level of the caps.

358. Any reduction in fee revenue may be recovered through higher interest rates, which would increase the amount of cross-subsidisation between borrowers. Borrowers who cause the lender to incur lower proportionate costs would subsidise borrowers who cause the lender to incur higher proportionately higher costs.

359. To assess this cost, we would be interested in feedback on the extent of the efficiencies that come from individual lenders setting cost-reflective fees, and whether these efficiencies justify the costs, complexities and difficulties of the current law.

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

360. Under this option, regulation of mandatory fees would be removed, and interest rates and fees would be bundled into an annual percentage rate (APR) for disclosure and advertising purposes.

361. This would be similar to the 'annual finance rate' used prior to the CCCFA coming into force in 2004, and the APR used in other jurisdictions such as the United States and the United Kingdom. However, care would need to be taken to avoid the problems that caused the annual finance rate to be abandoned in the first place. These included:

   a. Some fees were excluded from the annual finance rate, while the status of others was unclear. Some lenders would make efforts to exclude fees from the annual finance rate where possible, resulting in annual finance rates generally understating the cost of credit.

   b. The annual finance rate was difficult for consumers to interpret and make decisions based on it.

c. The annual finance rate was not generally disclosed in advertisements, which made it unhelpful for consumers who were trying to find the best credit offer. By the time it was disclosed to consumers, they were already psychologically committed to the loan.

Benefits of Fees Option C

362. Fees Option C could improve the comparability of credit offerings by ensuring that mandatory fees are taken into account by borrowers, who might otherwise focus only on the interest rate.

363. Lenders would no longer need to ensure that mandatory fees were reasonable. This means they would not need to perform cost calculations for most fees, or deal with difficult apportionment issues in determining which costs are closely connected to specific lending activities.

Costs of Fees Option C

364. Fees Option C would involve significant transition costs for lenders due to the need to change all advertising and disclosure of interest rates and fees.

365. Disclosure of equivalent interest rates in a timely and accurate way is likely to be challenging. Where mandatory fees are charged, equivalent interest rates have an inherent limitation of only representing the cost of credit for a contract for a particular term and amount. They are also difficult to apply to revolving credit contracts, as the balance varies over time depending on advances and payments made.

Potential for tightening regulation of third-party fees

366. There is some uncertainty about what fees charged by third parties (i.e. persons other than the creditor) are considered “credit fees” and are therefore subject to the prohibition on unreasonable fees. There is also uncertainty about what is required for a third party fee to be reasonable.

367. This uncertainty creates opportunities for unreasonable third-party fees to be charged.

368. Currently the CCCFA defines “credit fees” as:

> ***credit fees*** *means fees or charges payable by the debtor under a credit contract, or payable by the debtor to, or for the benefit of, the creditor in connection with a credit contract, and—*
>
> *(a) includes—*
>
> (i) establishment fees:
> (ii) prepayment fees as defined in section 43(2) (whether in relation to part prepayments or full prepayments):

(iii) insurance premiums payable for credit-related insurance if the creditor requires the debtor to obtain insurance cover from a particular insurer or particular insurers:

(iv) fees and charges payable as referred to in section 45 if the other person, body, or agency referred to in that section is an associated person of the creditor; but

(b) does not include—

(i) interest charges:

(ii) charges for an optional service:

(iii) default fees:

(iv) government charges, duties, taxes, or levies:

(v) fees and charges payable as referred to in section 45 if the other person, body, or agency referred to in that section is not an associated person of the creditor.

Uncertainty about which fees charged by third parties are "credit fees"

369. Fees charged by a third party and payable from the proceeds of the loan are "credit fees" if the third party is related to the creditor, but are not credit fees if the third party is unrelated to the creditor. For example, a finance broker who is unrelated to the creditor can have their fee added to the loan without it being a credit fee. The consequence of this is that there are no requirements for unrelated third-party fees to be reasonable. Section 45 provides that the creditor simply passes on the third-party fee, and cannot add its own margin to the fee.

370. The theory behind these provisions appears to be that there are minimal incentives for creditors to enter into relationships with third parties that involve excessive fees being added to the loan, where the parties are unrelated and the creditor does not gain directly from the fee. Based on this argument, further regulation of the level of the third-party fee would seem to be unnecessary.

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

372. Some possible incentives for these arrangements existing and excessive broker fees being charged could be:

   a. The creditor may see benefits from outsourcing certain functions to brokers (such as loan applications), and may be ambivalent about the level of the broker fee. The borrower may not take much account of broker fees when applying for the loan, particularly as these will be disclosed separately from the interest rate charged by the lender and the price of any goods being purchased on credit.

b. The creditor also receives interest from the addition of the broker fee to the loan balance.

373. We would welcome further feedback on the extent of this issue, and whether further consideration needs to be given to the boundary between third-party fees that are credit fees and third party fees that are not credit fees. One possibility would be to treat mandatory third-party fees as 'credit fees', although it is not clear if this would be practical, or what the effect would be.

3.7 Options to provide greater consumer protections for debt collection

374. In the event that the issues are widespread or serious enough to merit intervention, we have set out five options for addressing potential harms caused by debt collection practices:

a. Debt Collection Option A: increase disclosure requirements at commencement of debt collection

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

c. Debt Collection Option C: limit contact between the debt collector, borrower and other persons

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

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

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

Debt Collection Option A: increase disclosure requirements at commencement of debt collection

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

a. the name of the original creditor

b. the date on which the debt was passed to the debt collector

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

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

e. information about the rights of the borrower, including:

   i. an explanation of how to dispute the debt (including if the credit contract was not responsibly entered into) and contact details for the relevant dispute resolution scheme

   ii. information on how to make a hardship application; or, if Option 5B is adopted, advice that the borrower can request an affordable repayment plan at any time

   iii. if Debt Collection Option C is adopted, advice that the borrower can request that the debt collector cease contact at any time, or that the borrower can nominate a person that the debt collector must contact

   iv. an explanation of the legal rights of both parties, including how court enforcement and bankruptcy processes work

f. contact information for budget advisory services

g. a copy of the credit contract and any agreed variations.

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

378. This requirement would sit alongside existing guidance in the Responsible Lending Code for missed payments (see Responsible Lending Code 12.3 and 12.4).

379. The US Fair Debt Collection Practices Act requires that similar information be disclosed within five days of initial communication with the borrower. The debt collector must communicate key facts about the size and ownership of the debt, as well as the legal rights of the borrower. The borrower then has 30 days to dispute the debt. If the debt is disputed, the onus is on the debt collector to prove the accuracy of the facts by providing evidence or a copy of a court judgement.

380. It is also in line with UK legislation (FCA Handbook CONC 7.3.7 and CONC 7.4.1) which recommends that defaulted customers be provided with information on the size of their debt and referred to a non-for-profit debt advice body.

381. The option in this discussion paper requires that similar information be provided to borrowers compared to UK and US legislation, but with more detail.

Benefits of Debt Collection Option A

382. This option would allow for both easier self-enforcement and public enforcement (e.g. by the Commerce Commission), by improving the transparency of debt collection processes. It would be easier for consumers and their advocates to enforce consumers' rights by direct negotiation with the debt collection agency or, if necessary, by escalating a complaint to the appropriate Disputes Resolution Scheme.

383. It could reduce false and misleading claims, as debt collectors would need to provide evidence of the debt and information about legal rights from the outset.

Costs of Debt Collection Option A

384. Creditors and debt collectors would incur compliance costs in preparing these disclosures.

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

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

386. This option would mandate that debt collectors undertake the following steps:

    a. Debt collectors will be required to offer to conduct a new affordability assessment.

    b. If an affordability assessment is requested, the debt collector will undertake reasonable inquiries to assess the maximum amount that the borrower can repay without substantial hardship.

    c. A new repayment schedule would be prepared, based on either the maximum amount affordable, or the repayments under the original contract, whichever is the lesser. The borrower could volunteer to pay more than the repayments under the original contract, but this could not be demanded, and could not exceed the maximum affordable repayments. If the loan could not be repaid in a reasonable time in affordable amounts, the creditor would need to:

        i. reduce the interest rate or partly write off the debt and thus offer a reasonable repayment schedule, or

        ii. take official enforcement action such as repossession or court proceedings.

    d. Once a new repayment schedule is established, no payment demands could be made other than in accordance with the latest repayment schedule.

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

388. This option would extend CCCFA obligations around considering relief in cases of "unforeseen hardship", and general responsibilities to treat borrowers in default reasonably and ethically. Currently the Responsible Lending Code provides that where a borrower does not meet the criteria for relief on the grounds of unforeseen hardship but is willing to work with the lender, a lender should consider agreeing to a repayment plan,

accepting reduced payments for a reasonable period of time, and reducing or cancelling further interest or default fees (Responsible Lending Code 12.14).

389. For comparison, the UK's FCA Handbook requires that "a firm must treat customers in default or in arrears difficulties with forbearance and due consideration" (CONC 7.3.4). This could be done by considering reducing or waiving further interest or charges when the customer provides evidence of financial difficulties and is unable to meet the repayments (CONC 7.3.5), and allowing deferred payment terms or token payments (CONC 7.3.5). The debt collector should ultimately allow the borrower reasonable time and opportunity to repay the debt (CONC 7.3.6).

390. The FCA Handbook further requires that firms not pressure customers to pay their debts in a single payment or in unreasonably large amounts when this would adversely impact their financial circumstances (CONC 7.3.10).

Benefits of Debt Collection Option B

391. This option would reduce issues around debt collectors demanding unaffordable repayment plans. It would also provide a structured process for borrowers who were willing to repay their loans, to do so at an affordable rate, resulting in significantly less financial and emotional stress and harm.

392. It would also help to address issues related to borrowers being given unaffordable loans. It would reduce incentives to issue unaffordable loans, as these would be more likely to need to be written down[33] following default. Borrowers who had their loans written down would benefit, as would the borrower's other creditors, as the borrower would not be pushed into bankruptcy or further hardship.

Costs of Debt Collection Option B

393. We expect that this option would require debt collection processes to be significantly reworked in order to comply with new requirements. Creditors and debt collectors would incur significant upfront compliance costs as they invest in new processes.

394. The new process will reduce the ability of debt collectors to pursue debts using their existing methods, which is likely to reduce recovery rates. Some costs of default may consequently be passed on to non-defaulting borrowers through higher interest rates.

395. Additional enforcement and proactive guidance will be needed from regulators to assist compliance with these new requirements and address non-compliance. This would result in significant ongoing regulatory costs.

[33] This means the some of the interest or fees in the total amount owed are waived.

Debt Collection Option C: limit contact between the debt collector, borrower and other persons

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

397. The borrower would also have the right to nominate a representative that the debt collector must contact instead.

398. The debt collector would be obliged to inform the borrower of the above rights in all communications with the borrower.

399. The debt collector could also contact other persons, but only for the purpose of finding out the borrower's contact details. The debt collector would be prohibited from discussing the debt with any other person.

400. Where contact is permitted, there would also be specific prohibitions on debt collectors making threats, using offensive or abusive language, and there may be limits on the number of times that a debt collector can make unsolicited contact with a person.

401. Similar rights are available to borrowers in the United States under the Fair Debt Collection Practices Act, and are intended to address issues with harassment. The US Fair Debt Collection Practices Act mandates that a debt collector not communicate with the consumer without consent, and that they communicate with the consumer's representative if asked to do so. They must also cease communication if the borrower requests it in writing (except to notify the borrower that they are invoking special remedies).

402. The FCA Handbook (CONC 7.9.4) requires that debt collectors not contact borrowers at unreasonable times, and respect requests about when and how they are contacted. It also has rules around physical visits to borrowers, requiring that they notify the borrower before visiting them (7.9.12), and that they behave in an appropriate and non-threatening manner (7.9.14).

403. The FCA Handbook (CONC 7.9.6) similarly requires that debt collectors not disclose or threaten to disclose information about the customer's debt to a third party and that that they maintain confidentiality regarding the debt (CONC 7.9.7).

Benefits of Debt Collection Option C

404. This option would be likely to significantly reduce harassment of borrowers. The extent of this reduction will depend on the level of enforcement.

Costs of Debt Collection Option C

405. This option will reduce the ability of debt collectors to pursue debts using some existing methods. This is likely to reduce recovery rates for some debt collectors. Some costs of default may consequently be passed on to non-defaulting borrowers through higher interest rates.

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

406. Under this option, debt collectors who are agents of a creditor would be directly subject to a number of CCCFA requirements. Currently creditors are responsible for the actions of their agents. By contrast, assignee debt collectors are already directly subject to the CCCFA. This change would create stronger incentives for third party debt collectors to comply with CCCFA, as they would be directly liable for breaches.

407. Third party debt collection agents would be required to register on the FSPR and join a dispute resolution scheme.

408. In addition to any requirements taken forward from Debt Collection Option A–C, the relevant requirements could include equivalents of:

    a. 9C(2)(a) – exercise the care, diligence, and skill of a responsible debt collection agent in all dealings with a borrower

    b. 9C(3)(b) – assist the borrower to reach an informed decision as to what action to take in respect of any defaulted debt, including any information provided by the debt collection agent to the borrower is not presented in a manner that is, or is likely to be, misleading, deceptive, or confusing

    c. 9C(3)(d) – treat the borrower and their property (or property in their possession) reasonably and in an ethical manner

    d. 9C(3)(e) – ensure, in the case of an agreement to which Part 5 applies, that the agreement is not oppressive, the debt collection agent does not exercise a right or power conferred by the agreement in an oppressive manner, and that the debt collection agent does not induce the borrower to enter into any agreement by oppressive means.

Benefits of Debt Collection Option D

409. This option would create stronger incentives for third-party debt collection agents to comply with key CCCFA obligations, and greater clarity for debt collectors and consumers around what their obligations were. It would result in greater consistency across the industry, ensuring equivalent obligations on all debt collectors and across the lifetime of a loan.

410. Enforcement options and access to redress would become more straightforward. Requiring third-party agents to independently sign up to disputes resolution schemes could provide borrowers with more consistent, low cost, and more accessible redress for borrowers. This would particularly benefit vulnerable consumers, whose financial situations often mean they cannot afford lawyers and an expensive court process.

411. FSPR registration would also allow it to be clearer when overseas debt collectors are operating in New Zealand, and would enable greater oversight. This could make enforcement action easier.

Costs of Debt Collection Option D

412. It would increase compliance requirements for third-party agents, although given that third-party debt collection agents are already supposed to be meeting these obligations (albeit without direct liability), these costs would be small for compliant agents. There would be small costs for FSP registration.

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

413. Many credit contracts include a general clause in which the borrower in default agrees to pay any costs incurred by the creditor in attempting to recover amounts owing.

414. The CCCFA provides that “default fees” must be reasonable, but it is unclear how this applies to fees charged by an external debt collector. Section 44A(1) requires the court to have regard to whether the fee reasonably compensates the creditor for a cost it incurs. This will generally be the case where the creditor is passing on a third-party fee. The additional requirement in section 44A(2) that the court have regard to reasonable standards of commercial practice appears to be a relatively high threshold for declaring a fee unreasonable.

415. This leaves wide latitude for third-party debt collectors to charge high fees to the borrower, and creditors currently have weak incentives to limit these.

416. Under this option, only the actual costs incurred by debt collectors acting as agents of creditors could be passed on to borrowers. Any additional fees or commissions charged by the debt collector would need to be paid by the creditor.

Benefits of Debt Collection Option E

417. This option would reduce problems with borrowers being charged excessive debt collection charges. It would be more effective if debt collectors were also subject to the substantiation obligation in Fees Option A.

Costs of Debt Collection Option E

418. This option would impose compliance costs on debt collectors acting as agents for creditors, who would need to separate their actual collection costs from other charges.

419. Creditors would be left with greater costs from debt collection, which may be passed on to defaulting borrowers in the form of higher default interest rates.

Annex 1: stakeholders consulted

Government departments	Other government entities
1. Ministry for Social Development	5. Reserve Bank of New Zealand
2. Ministry for Pacific Peoples	6. Commerce Commission
3. Te Puni Kōkiri	7. Financial Markets Authority
4. The Treasury	8. Commission for Financial Capability
Dispute resolution services	**Consumer advocates**
9. Financial Services Complaints Ltd	13. National Building Financial Capability Charitable Trust
10. Financial Disputes Resolution Service	14. Whānau Manaaki Kindergartens (Whānau Ora Navigators)
11. Insurance and Financial Services Ombudsman	15. Citizens Advice Bureau
12. Banking Ombudsman	16. Community Law Centres (Auckland and Waikato)
	17. Consumer NZ
Lenders	**Other stakeholders**
18. 6 lenders	21. A debt collector
19. Ngā Tangata Microfinance	22. Financial Services Federation
20. Good Shepherd	23. New Zealand Bankers Association
	24. A consumer advocate
	25. A law firm