Office of the Minister of Commerce and Consumer Affairs

The Chair
Cabinet Economic Growth and Infrastructure Committee

Credit Contracts and Consumer Finance Act 2003: consequences of non-compliant information disclosure

Proposal

1 This paper proposes to amend section 99(1A) of the Credit Contracts and Consumer Finance Act 2003, so that lenders can seek relief from a court, from the requirement to forfeit interest and fees when they make non-compliant information disclosure.

Executive summary

Background

2 Firms that lend to consumers have certain obligations towards those consumers under the Credit Contracts and Consumer Finance Act 2003 (the "CCCF Act"), in particular an obligation to disclose certain key information (such as the annual interest rate, the existence of any fees, etc.).

3 If the lender fails to disclose such information properly, the CCCF Act sets out a number of legal consequences. For example, the borrower has certain rights to cancel the loan; the lender may be liable to the borrower for statutory damages and may have to pay a fine; and, under section 99(1A) of the CCCF Act, a borrower is not liable for any 'costs of borrowing' (interest or fees) that fall due between the date of the failure and the date that failure is remedied. In other words, a lender forfeits the interest and fees that fall due during the period the information disclosure obligations are and remain breached.

4 The requirement under section 99(1A) to forfeit 100% of interest and fees for the period of non-compliance has been criticised by lenders as inappropriate and disproportionate, because it applies regardless of how significant the non-compliance is.

5 Following Cabinet approval in October 2016 [EGI 16-MIN-0276 refers], I published a discussion paper on 2 November 2016. The discussion paper asked respondents whether section 99(1A) should be amended and, if so, how. This paper constitutes my report back to Cabinet.

The need for change

6 Section 99(1A), as drafted, has the potential to create highly damaging consequences for minor or technical disclosure breaches. The viability of some lenders could be put at risk by section 99(1A) in its current form. In addition, undue effort may be expended on checking and rechecking disclosure documents, which has the potential to lead to slower loan processing times and added expense for lenders (that could translate into higher interest rates and fees for borrowers).

7 In this context, I consider that some form of amendment or replacement should be considered.

Change proposed

8 I considered a number of approaches to amending or replacing section 99(1A).

9 The approach I am proposing would involve amending section 99(1A) in a way that allows lenders the right to apply to a court for relief from the requirement to forfeit 100% of the relevant interest and fees. A court could order a reduction in the amount to be forfeited, according to factors such as the gravity of the breach.

10 This approach reduces the risk of damaging financial impacts on lenders who breach their information disclosure obligations. At the same time, by requiring a court's involvement before a lender can be granted relief, it helps ensure fair treatment of borrowers.

Retroactive application of amendments

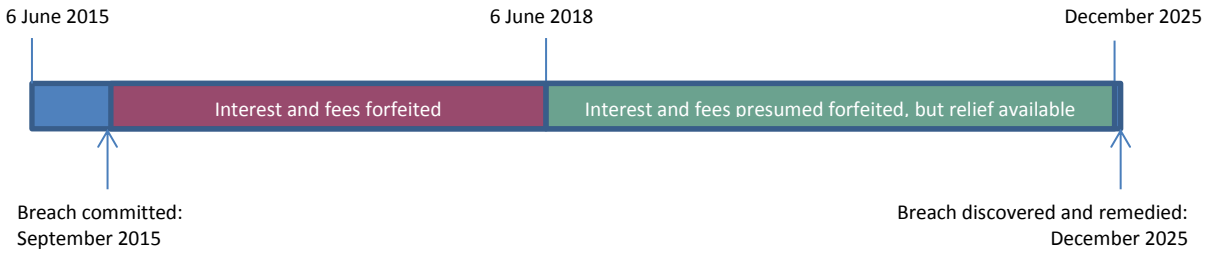
11 If my proposed amendment to section 99(1A) is made, a key issue is to what extent lenders should be able to apply for relief from the requirement to forfeit interest and fees, if their breach of information disclosure obligations occurs before the proposed amendment enters into force.

12 I consider it fair to all parties that, for such breaches:

a. in respect of any interest and fees forfeitable prior to the entry into force of the amended section 99(1A), the lender *should not* have the right to apply for relief from the courts;

b. in respect of any interest and fees forfeitable after the entry into force of the amended section 99(1A), the lender *should* have the right to apply for relief from the courts.

13 Given the entry into force of the current section 99(1A) was 6 June 2015, and assuming entry into force of the amended section 99(1A) on 6 June 2018, the proposed approach can be illustrated as follows. Here I assume that the disclosure breach occurs in September 2015 (before the proposed amendment takes effect) but is not discovered and remedied until many years later (December 2025).



14 I do not consider it appropriate that full retroactive relief should be available i.e. that a lender in this case could seek relief for repayment of interest and fees charged before the amendment came into force.

Background

15 Firms that lend to consumers have certain obligations towards those consumers under the CCCF Act, in particular an obligation to disclose certain key information (such as the annual interest rate, the existence of any fees, etc.):

a. before the loan agreement is signed ("initial disclosure" required by section 17); and

b. whenever the loan agreement is varied ("variation disclosure" required by section 22).

16 If the lender fails to accurately disclose such information, the CCCF Act sets out a number of legal consequences, such as:

a. the borrower has certain time-limited rights to cancel the loan;

b. the lender may be liable to the borrower for damages and may have to pay a fine; and

c. under section 99(1A) of the CCCF Act, the lender must forfeit any interest or fees that fell due during the period of failure to disclose information.

17 On 17 May 2016, the New Zealand Bankers Association ("NZBA") wrote to the Ministry of Business, Innovation and Employment ("MBIE") concerning section 99(1A) of the CCCF Act. In its letter, the NZBA wrote that "members are concerned that creditors must refund costs of borrowing in all situations, even if they've corrected non-disclosure or there is no material harm to the borrower". The NZBA asked that the provision be amended or repealed.

18 In subsequent meetings, NZBA also asked that the law be changed with retroactive effect (so that all non-compliant disclosures made since 6 June 2015 would be protected from the current 100% forfeiture rule).

19 Following Cabinet approval in October 2016 [EGI 16-MIN-0276 refers], a discussion paper was released on 2 November 2016. The discussion paper asked respondents whether section 99(1A) should be amended and, if so, how.

The need for change

Why section 99(1A) should not be repealed…

20 Repeal would require a determination that section 99(1A) is unnecessary i.e. that the remaining legal consequences of non-compliance are sufficient:

a. to provide adequate compensation to borrowers for the harm they suffer; and

b. to provide adequate incentive for lenders to comply with their disclosure obligations.

21 I consider that, without section 99(1A) or something to replace it, the other consequences of non-compliance are sufficient to compensate borrowers.

22 However, I consider that, without section 99(1A), the other consequences of non-compliance provide inadequate incentive for compliance. I understand that a minority of lenders only began paying full attention to their disclosure obligations as a result of section 99(1A).

… but should be amended or replaced

23 I agree with respondents who argue that section 99(1A), as drafted, has the potential to create highly damaging consequences:

a. For lenders, the evidence from a confidential respondent facing a significant forfeiture (several millions of dollars) is particularly compelling. There is a risk that the viability of some lenders could be put at risk by the continued existence of section 99(1A) in its current form.

b. For borrowers, I agree that undue effort expended on checking and rechecking disclosure documents has the potential to lead to slower loan processing times and added expense for lenders (that could translate into higher interest rates and fees for borrowers). Conversely some borrowers are benefitting from undue windfalls, through escaping liability for interest and fees.

24 I also agree with lenders that the current provision can lead to disproportionate penalties. I note that even the Commerce Commission (which favours allowing relief for lenders) acknowledges in its submission that "there may be some unusual cases in which the application of section 99(1A) could result in lenders forgoing revenues in an amount which is disproportionate to the nature of the breach and likely consumer harm". It also acknowledges that "[w]hile the Commission's exercise of its prosecutorial discretion permits a proportionate enforcement response, that cannot preclude or provide any mitigation against private action by a borrower, or group of borrowers".

25 In this context, even though section 99(1A) is clear and simple to enforce, I consider that some form of amendment or replacement should be considered.

Options

26 I have considered a number of approaches to amending or replacing section 99(1A) and present below the three main options.

27 The first option would involve setting different proportions of interest and fees that must be forfeited under section 99(1A), according to the 'importance' of the information that was not properly disclosed. For example, it would be possible to amend section 99(1A) so that a lender must forfeit, say:

a. 100% of the relevant interest and fees when the breach concerns the total amount of money to be lent, the annual interest rate, or the fees payable;

b. 50% of the relevant interest and fees when the breach concerns the borrower's rights of cancellation or the name and details of the relevant dispute resolution provider; and

c. 10% of the relevant interest and fees when the breach concerns other (less material) items of information required to be disclosed.

28 The second option would involve amending section 99(1A) in a way that allows lenders the potential for relief from the requirement to forfeit 100% of the relevant interest and fees. The precise formulation of the relief provision would be subject to drafting. However, it would require the lender to seek a court order. The court could reduce the amount the lender must forfeit, according to such factors as the gravity of the breach.

29 The third option would be to repeal section 99(1A) but (by way of replacement) to increase the level of statutory damages to which a borrower would be entitled for a breach of section 17 (initial disclosure) or section 22 (variation disclosure). That level is currently set at 5% of the interest and fees that fell due during the period of non-compliance, capped at $6,000. This could be raised to the level of statutory damages set for a breach of section 18 of the CCCF Act (continuing disclosure at least every 6 months), which is 100% of the interest and fees that fell due during the period of non-compliance, uncapped.

List of different options

Category	Option	Description
Amend	1	Amendment to section 99(1A) – lenders face varied levels of forfeiture (caps)
	2	Amendment to section 99(1A) – lenders can rebut presumption of forfeiture before a court
Replace	3	Replacement of section 99(1A) – lenders no longer face forfeiture but face increased statutory damages

Assessment

Option 1

30 Amending section 99(1A) to set varied levels of forfeiture would introduce some proportionality into the consequences of section 99(1A): an error of little importance would no longer see the lender forfeit all of the relevant interest and fees.

31 However, I have a number of concerns with this option:

a. choosing which information is more important and which is less important would be a somewhat arbitrary decision, as would setting the corresponding proportion of interest and fees (e.g. 100%, 50%, 10%) that the lender forfeits;

b. the option still does not take account of whether a lender's failure to disclose the information was wilful or inadvertent.

32 In addition, not all errors are the same, even when they concern the same piece of information. For example, imagine two lenders each issue a loan to the same person. Imagine that one lender accidentally stated the interest rate to be 20% but actually only charges 15%, while the other lender accidentally stated the interest rate to be 10% but also actually charges 15%. Under Option 1, both lenders would be subject to 100% forfeiture of the interest and fees at stake, yet it is only the second lender who has misled the borrower to his or her detriment.

33 Overall, I do not consider Option 1 to be appropriate.

Option 2

34 Allowing lenders the right to rebut (before a court) a presumption of forfeiture has a number of strengths. In particular, it would reduce the risk of disproportionate (and in some cases damaging) financial impacts on lenders who breach their information disclosure obligations, and accordingly free lenders from undertaking the excessive compliance verification that the current section 99(1A) has induced in some lenders. By requiring a court's involvement, it would ensure a measure of borrower protection.

35 At the same time, by maintaining a presumption of forfeiture in borrowers' favour, it ensures that the responsibility for displacing the presumption sits with the party that (i) committed the breach of the CCCF Act and (ii) is best placed to argue its case before a court.

36 Option 2 raises some enforcement risks for consumer borrowers, compared to the status quo. For any consumer borrower, a threat of court action (initiated by the lender to obtain relief) could be quite an intimidating prospect. The consumer may feel reluctantly compelled to accept the lender's assertion that it has a valid defence, and accept an inadequate settlement.

37 However, these concerns are relatively minor, and this option appears broadly satisfactory.

Option 3

38 Option 3 would involve repealing section 99(1A) – so that a lender need no longer automatically forfeit the interest and fees associated with a period of non-compliant disclosure – but (substantially) increasing the amount of statutory damages to which a borrower is entitled.

39 This option also has a number of strengths. Like Option 2, it would reduce the risk of disproportionate and damaging financial impacts on lenders, and would also ensure that borrowers were not over-compensated for minor lender errors. This is because there are defences available to lenders under the CCCF Act statutory damages regime: an 'all or nothing' defence under section 106 (which does not require a court order) and an ability to apply to a court for reduction of damages under section 91.

40 However, it is within one of these strengths that the main weakness of Option 3 lies. Specifically, I am concerned that the ability of a lender to escape forfeiture under section 106, without a court order, would increase the risk that lenders will not proactively refund borrowers. In sum, I agree with the Commerce Commission's statement in its response to the discussion paper: "Any reform that permits modification of the basic borrower right not to pay the costs of borrowing should require an application by the lender to the Court. Otherwise, the borrower will be uncertain as to their entitlement, and the lender – who knows the facts best – is in a position to dictate an outcome".

Conclusion

41 I recommend Option 2 (lenders can rebut presumption of forfeiture). It sets an appropriate level of deterrence and penalisation for lenders; it ensures an appropriate level of compensation for borrowers; and it presents only minor enforcement risks for borrowers.

42 In addition, unlike under Option 3 (change to statutory damages), under Option 2 a lender would in all cases need to apply to a court for a relief order. Any relief order granted would set the level of lender forfeiture according to the gravity of the lender's breach.

Retroactive application of amendments

Context

43 A number of stakeholders[1] consider that any amended form of section 99(1A) should apply to non-compliant disclosures that occur prior to amendment. In other words, they argue that any reform of section 99(1A) should apply not just prospectively but also to the past.

44 They have advanced several justifications for this position:

- First, they note that the original section 99(1A) was inserted into the relevant Credit Contracts and Financial Services Law Reform Bill three days before its introduction, and that the provision largely escaped attention from the select committee because the Bill was a significant and wide-ranging text of almost 120 pages.
- Second, they argue that, if – as a result of the first factor – the government acknowledges that the provision has been inappropriate since its introduction (rather than becoming inappropriate due to changing external context), then retrospective application would recognise this.
- Third, they argue that borrowers will not be unduly affected by retrospective application, because they will continue to have access to a wide range of remedies for non-compliant disclosure by a lender (including a right to cancel the loan agreement, and a right to statutory damages).
- Finally, they argue that, without retrospective application, lenders could face massive forfeitures if, for example, a breach of the information disclosure rules that occurred prior to amendment is only discovered many years in the future. They claim this poses prudential risks.

45 Other stakeholders[2] have, however, argued against any retrospective application of an amended section 99(1A).

[1] Three lender trade associations, the lenders ANZ and Linsa, the Motor Trade Association, and the law firms Russell McVeagh and Minter Ellison.
[2] The Commerce Commission, the Law Society, the Citizens Advice Bureau, the lenders EB Loans and DCO Finance, and the dispute resolution provider FS Complaints Ltd.

46 For example, the Commerce Commission submitted that a retroactive change would "be unfair to those lenders who have already resolved matters with borrowers, or the Commission" and would "interfere with current Commission investigations and, depending on the timing, matters before the Court".

Principles and precedent

47 According to the Legislative Advisory Committee Guidelines, there is a presumption against legislative provisions having retrospective effect.

48 However, this presumption can be rebutted in exceptional circumstances, for example where the legislation is to the benefit of those affected. Ultimately the question is whether retrospective application would be fair to all involved.

49 Parliament has previously introduced similar provisions with retrospective effect. For example, the Securities Act 1978 (now repealed) was amended in 2004 in order to address inadvertent breach by fund managers of rules requiring the filing of certain documents, which had exposed them to significant penalties. The amendments allowed a court – on the application of "the issuer of a security" – to make an order for relief from the penalties set out in the Act. In effect, they introduced a "fund manager defence".

50 What is particularly relevant is that the amendments provided that an order could be made under the new relief provisions "regardless of whether the contravention ... occurred before or after this section comes into force".[3] In other words, a defence would be available even for breaches which took place before the defence provision was in place. The select committee that recommended this provision stated (over the objections of some investors) that "[t]he retrospective nature of this process is fair to all parties affected by the breaches of sections 37(1) and 37A".[4]

Discussion

51 I consider that there are grounds for some form of retrospective application of an amended section 99(1A). In other words, there should be some circumstances in which a lender can apply to the courts for relief from the presumption of 100% forfeiture of the relevant interest and fees, even though the lender breached the disclosure obligations while the "old" version of section 99(1A) was in force i.e. prior to amendment.

52 The alternative is to expose lenders to ongoing risk of forfeiture, long after the law has changed. For example, imagine that a lender makes non-compliant disclosure in September 2015. This breach is only discovered in May 2025. If no retrospectivity is applied, the lender will have no ability to claim relief, so will have to forfeit interest and fees that fell due from September 2015 – May 2025: in all likelihood an undeserved windfall for the borrower and a serious financial hit for the lender.

[3] See sections 37AC(2), 37AH(2) and 37C(2) of the Securities Act 1978.
[4] Report of the Commerce Committee on the Business Law Reform Bill, February 2004, at pp.7-8.

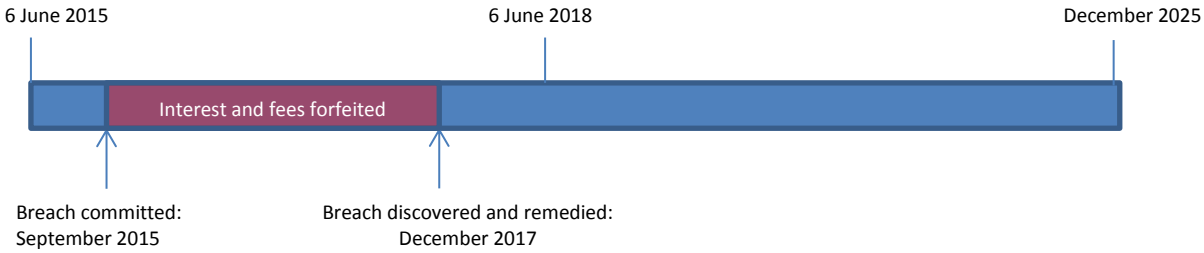
53 However, I agree with the Commerce Commission that allowing for full retroactive application of the ability to claim relief would mean that firms such as Cash in a Flash (with whom the Commission reached a settlement in 2016) could attempt to 'undo' settlements, on the basis that they were negotiated under rules that never actually applied.

54 In this context, I consider that the appropriate solution, fair to all parties, is that where a lender breaches section 99(1A) in the period before its amendment, the lender:

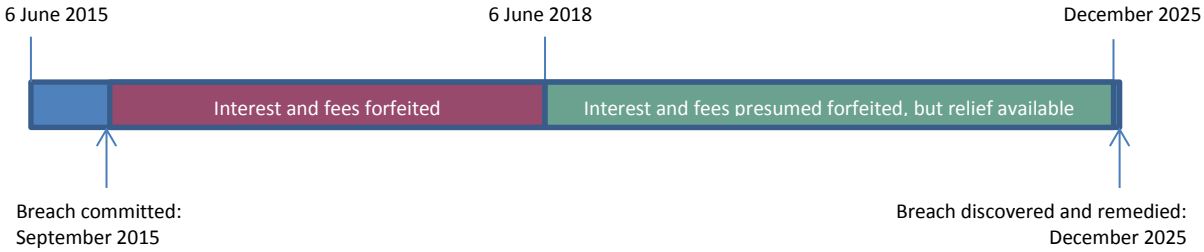
- in respect of any interest and fees forfeitable prior to the entry into force of the amended section 99(1A), *should not* have the right to apply for relief from the courts;
- in respect of any interest and fees forfeitable after the entry into force of the amended section 99(1A), *should* have the right to apply for relief from the courts.

55 The effect of this approach can be illustrated through the following examples. Both examples assume that the amended section 99(1A) enters into force in June 2018.

Example A: A lender makes non-compliant disclosure in September 2015 (i.e. before the amended provision takes effect). This breach is discovered and remedied in December 2017 (i.e. before the amended provision takes effect). The lender must forfeit interest and fees that fell due from September 2015 – December 2017.



Example B: A lender makes non-compliant disclosure in September 2015 (i.e. before the amended provision takes effect). This breach is discovered and remedied in December 2025 (i.e. after the amended provision takes effect). The lender must forfeit interest and fees that fell due from September 2015 – June 2018. The lender is also presumed to forfeit interest and fees that fell due from June 2018 – December 2025, *but* has the right to request relief from the courts from this presumption.



56 This approach would have only a very limited retrospective effect. If we imagine a borrower was given incomplete disclosure in, say, September 2015, that borrower would retain the right to escape interest and fees up to the date that the amended section 99(1A) enters into force. It would also retain a presumption in its favour that it would escape interest and fees that fall due after this time. What it would lose is an absolute guarantee, that in all circumstances after the date section 99(1A) is

amended, it would escape the relevant interest and fees. I consider that a minor loss.

57 The proposed approach would also have the following advantages:

- PROTECTION FOR LENDERS: In scenarios where a breach prior to amendment remains undiscovered for many years after section 99(1A) is amended, leading to potentially catastrophic financial impacts for the lender, the lender will have the right to apply for relief from the courts;

- PROTECTION FOR BORROWERS: Cases begun against lenders, and settlements completed, by the time the amended provision enters into force would remain unaffected. Any other outcome would be unfair to the borrowers concerned. People should be entitled to retain the fruits of their litigation.

Next steps

58 I intend to issue drafting instructions to the Parliamentary Counsel Office to draft legislation to give effect to the proposals in this paper.

59 A legislative vehicle for any amendments to section 99(1A) exists in the form of the Financial Services Legislation Amendment Bill, which is likely to be introduced to Parliament in June or July 2017.

Consultation

Public consultation

60 A discussion paper was released on 2 November 2016. 19 submissions were received, of which two were confidential. MBIE published the 17 non-confidential submissions on the MBIE website on 14 December 2016.

Agency consultation

61 On issues concerning the CCCF Act, my officials at MBIE have consulted with Treasury, the Reserve Bank, the Ministry of Social Development and the Legislative Design Advisory Committee. No objections have been raised.

62 The Department of Prime Minister and Cabinet, the Ministry of Justice and the Ministry for Pacific Peoples have been informed.

Financial Implications

63 This paper has no financial implications.

Human Rights

64 This paper has no human rights implications.

Legislative Implications

65 This paper will lead to an amendment to section 99(1A) of the CCCF Act.

Regulatory Impact Analysis

66 The Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement (RIS) prepared by MBIE. They consider that the information and analysis summarised in the RIS meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Publicity

67 I intend to publish a media statement announcing the proposal to amend section 99(1A) soon after the Cabinet decision is taken.

68 My officials will also make updates to the MBIE webpage on which the public consultation was announced.

Risks

69 Retrospective application of legislative provisions (even the extremely limited form proposed here) is unusual and may attract media attention. This risk can be managed by stressing in media materials:

a. the strictly limited nature of the substantive reform to section 99(1A): the presumption of lender forfeiture will remain and lenders will simply have a right to apply for relief, and the final decision will rest with the courts; and

b. the fact that action already being taken against lenders under section 99(1A), or already completed, by the time the amended provision comes into effect, will not be revisited: lenders will not have the right to apply for relief in any such cases.

70 On the other hand, a number of lenders may be critical of the limited retroactivity being proposed. Lender criticism can be managed by noting:

a. that the decision on retroactivity was one guided by the principle of fairness to both lenders and borrowers, and that the limited retroactivity proposed strikes the appropriate balance;

b. in any private correspondence with the lender facing a $7.5 million settlement, that the lender may wish to consider whether it has a legal case against its solicitors, who prepared and vouched for the accuracy of the disclosure forms the lender used.

71 Finally, discussions are ongoing with the Parliamentary Counsel Office over whether the Financial Services Legislation Amendment Bill is the best vehicle for implementing changes to section 99(1A) of the CCCF Act. It is possible that another vehicle will need to be found. This could create a risk of delay in implementing the changes.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the committee:

1. **note** that, where a lender fails to make proper disclosure of key information to a consumer (such as what the interest rate is), a number of consequences apply under the Credit Contracts and Consumer Finance Act 2003 including, under section 99(1A), the forfeiture by the lender of 100% of the interest and fees due for the period of non-compliance;

2. **note** that in October 2016 Cabinet agreed that the Minister of Commerce and Consumers Affairs should publish a discussion paper seeking views on whether section 99(1A) should be amended and, if so, how [EGI 16-MIN-0276 refers];

3. **note** that this paper constitutes the report back to Cabinet by the Minister of Commerce and Consumers Affairs;

4. **agree** that section 99(1A) should be amended, so that in future a lender has the right to apply to a court for relief from the presumption of 100% forfeiture of all interest and fees;

5. **agree** that, where a lender breaches section 99(1A) in the period before its amendment:

   5.1. the lender *should not* have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the breach (e.g. in September 2015) and the entry into force of the amended section 99(1A) (e.g. June 2018); but

   5.2. the lender *should* have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the entry into force of the amendment (e.g. June 2018) and the date the breach is discovered and remedied (e.g. April 2025);

6. **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to draft legislation to give effect to the decisions in the recommendations 4 and 5; and

7. **authorise** the Minister of Commerce and Consumer Affairs to make minor or technical changes, consistent with the decisions in this paper, on any issues that arise during the drafting process.

Hon Jacqui Dean
Minister of Commerce and Consumer Affairs

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