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Competition & Consumer Policy
Ministry of Business, Innovation & Employment
Email: consumer@mbie.govt.nz

Review of consumer credit regulation

Our submissions are informed by our role as an independent dispute resolution scheme, which investigates complaints across a broad spectrum of financial advice, services, and products (except banking).

In the year ended 30 June 2018, we formally investigated 51 complaints about lenders and handled approximately 2,000 initial complaints and enquiries about lenders. If the Ministry seeks further information about our complaint statistics or trends, please contact us.

As part of the body of our submissions we have included summaries of case notes, and the full case notes are provided in appendix one. FSCL prepares case notes after completing a complaint investigation. The case notes (which have all identifying information removed) detail the events leading up to each complaint, the positions of the parties, and the steps taken by FSCL to resolve the complaint.

We have not answered all the discussion paper questions, instead focussing on answering questions where we can provide insights based on the nature and outcome of complaints we investigate.

Issue 1: Excessive cost of some consumer credit agreements

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

We receive relatively few complaints about high-cost lending (HCL). This is surprising because we hear anecdotal evidence that many consumers get into spiralling debt situations after accessing HCL. Consumers may be reluctant to complain about HCL because they rely on the lending to meet their day to day living costs.

We rarely receive complaints about HCL which raise responsible lending issues, however, we outline below three cases which have.

Case example 1 (appendix 1, page 2)

> "Vicky took out a loan for $175. The total amount to pay was $440. This meant there were fees and interest totalling approximately 251% on the original loan. When Vicky missed payments, she was charged a $49 'bank dishonour' fee and a $30 'letter fee'. After making six of her required instalment payments ($55), Vicky had paid $330 but the loan balance was still $590. Vicky felt she would never be able to pay the debt."

Case example 2 (appendix 1, page 3)

> "William took out HCL loans for $100 and $200 and paid them back without incident. William applied for another $400 loan, and defaulted. His father helped him pay the loan. William then applied for another loan for $800 in August. William did not make payments and then, by the time William contacted FSCL in March, the balance of the debt was $2,070. William was able to come up with payment of the $2,070 and our investigation closed."

Case examples 1 and 2 show the effects of HCL on spiralling debt.

Although not one of the issues MBIE raised in the discussion paper, we note another HCL complaint highlighting the benefits of the responsible lending provisions:

Case example 3 (appendix 1, pages 4 and 5)

> "Awhina took out an initial loan for $150, and then another loan for $150. When Awhina did not pay the second loan the lender, under a clause in its terms and conditions, deducted an amount equal to the loan principal ($150). Awhina only had funds of $185 and this left her in strife when she only had $35 left. We said that although the lender's contract allowed it to deduct the whole principal in one payment, it still needed to treat Awhina reasonably and ethically (section 9C(3)(d)(i) of the CCCFA)."

In terms of options for addressing high interest and fees, we consider limiting the accumulation of interest and fees would assist in preventing a loan spiralling completely out of control and would help in setting an achievable repayment goal for the borrower, rather than an ever-increasing debt.

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

We support a cap on the number of HCL loans that could be taken out within a certain period of time. With reference to William's case above – he may have avoided entering into a debt spiral if there was a cap.

As outlined at paragraph 3.6 of the Responsible Lending Code (the Code), HCL is not suitable for long term lending. HCL has a purpose when unexpected events occur, and the borrower has no other source of ready funds. We therefore consider it could be detrimental for some consumers if high-cost lenders were to be constructively locked out of the market. Unless there is another source from which borrowers can access emergency loans quickly, the absence of HCL could mean people will borrow from unregulated persons. If a consumer is accessing HCL loans more regularly than every 90 days, there may be other social issues at play, that require addressing. We also question how lenders will know whether the consumer has taken out a HCL loan with another high-cost lender within the 90-day period.

Recently we spoke with Dr Rob Thomson who has established Debt Blocker, a service where consumers who know they can be vulnerable in relation to taking out loans, can register through Debt Blocker's website. Lenders can also register, and then conduct a search to check the prospective borrower has not registered, before lending. The benefit to the lender is they can avoid lending to a consumer who may be likely to default in the future, saving the lender time and money. More information can be found at www.debtblocker.nz . We support initiatives like Debt Blocker which have the aim of ensuring consumers do not fall into debt spirals/take out loans that are not in their interests.

Issue 2: Continued irresponsible lending and other non-compliance

We still see a number of complaints where irresponsible lending occurred prior to June 2015. In those cases, we may assist the parties in trying to reach negotiated resolutions for repayment of a debt that has increased over time or has become unaffordable for the borrower.

We investigate complaints where irresponsible lending has occurred post-June 2015. We have recently been investigating a complaint where, although most of the lending decisions were made prior to June 2015, a loan was moved into the sole name of a woman who was aged 76 (in October 2015), and who the lender had been aware was in hardship earlier that year.

Previously, the woman was the guarantor of her son's loans (the son was the primary beneficiary of the previous loans). The lender was of the view it acted responsibly in transferring the loan into the woman's sole name because she and her husband (prior to his death), had been guarantors, and had been voluntarily paying the loan.

However, the lender conducted no assessment of whether the October 2015 loan met the woman's requirements and objectives, whether she could afford the loan, and whether she understood the full implications of entering the loan so she could make an informed decision about entering into it. The lender failed to identify that, with the woman's son no

longer being a party to the loan agreement, the lender could not pursue payment from him. This was a material change from the status quo.

With reference to paragraph 39 of the discussion document:

a) (Paragraph 39(a)): We agree it is common for some lenders to perform only superficial testing of loan affordability. This is common where the lender has an agent gathering information about the borrower's financial position (for example via a finance broker or a car yard's salesperson). Neither the broker or the lender consider they should take responsibility when there is a complaint.

   We recently started investigating a complaint where a lender is of the view there can be no complaint about alleged irresponsible lending because it relied on the accuracy of the information its agent (car yard) gathered about a customer's financial position in assessing loan affordability. In other words, the lender is attempting to 'contract out' of its responsible lending obligations.

   We have also recently investigated a complaint from a woman who applied for a loan through a broker to purchase a vehicle for her and her partner. The loan was taken out in the woman's sole name because her partner had a bad credit rating. Soon after, the couple broke up and the partner kept the car. It transpired the woman had completed the loan application under duress. The woman complained about the broker's service; as a single mother, under duress, and on a benefit, she felt she should not have been lent to. She also felt that the broker had not communicated her liabilities to the lender.

   The broker did not believe the woman exhibited any signs of duress and that the decision to lend was ultimately that of the lender's. Based on the woman's application form and bank statements, the lender did not believe it had failed to meet its obligations under the Responsible Lending Code (the Code) when it determined the loan affordability.

b) (Paragraph 39(c)): As big an issue as borrowers not being aware they have bought insurance, are instances of consumers being sold credit related insurance when the policy may not be suitable for them:

   Case example 4 (appendix 1, pages 6 and 7)

   "Ruth and Luke purchased a vehicle on finance and were sold mechanical breakdown and income protection insurance at the same time. However, Luke was a mechanic and did not need mechanical breakdown insurance and the couple thought the income protection was actually unnecessary. Ruth and Luke thought they had to purchase the insurance to get the loan."

In all the cases we have seen, the insurance is paid for at the start of the loan by adding the premium (often several thousand dollars) to the sum borrowed, increasing the borrower's debt burden.

For example, we have recently received a complaint where a $12,000 loan was advanced, and credit-related insurance was purchased at the same time. The very expensive $4,000 insurance premium was paid upfront and financed by the lender. This means the lender has likely been earning interest not only on the advance, but also the premium payment. There may also be limited cover under the insurance in relation to the stand-down period, and it is unlikely the borrower will be able to claim under the policy.

We suggest that it be mandatory for lenders to offer borrowers, who want credit-related insurance and for whom the insurance product is suitable, the option of paying for the insurance by way of a monthly premium. This would avoid the borrower paying interest on the insurance premium.

c) (Paragraph 39(d)): We see cases where lenders are not as vigilant in their responsible lending obligations when it comes to guarantees:

Case example 5 (appendix 1, pages 8 and 9)

"A lender took a guarantee from George in relation to his son Paul's $2,000 loan. It transpired the lender had not carried out any affordability assessment on George's ability to pay the loan under the guarantee. When Paul defaulted almost immediately on the loan repayments, the lender pursued George for payments he could not afford."

<u>Paragraph 40</u>

We agree it is difficult for lenders to know the extent of their responsible lending requirements, for example, in unforeseen hardship applications. This caused us to produce a best practice guide to assessing financial hardship applications in 2017 for our scheme members. We saw there were inconsistencies in how lenders were complying with the CCCFA timelines for assessing applications, and in the information they were gathering from borrowers to assess applications. For example, in Yvonne's complaint:

Case example 6 (appendix 1, pages 10 and 11)

"Yvonne was told she could only apply for a variation of the credit contract on the grounds of unforeseen hardship if she and her husband had no income. This is not a requirement of the CCCFA, and Yvonne and her husband's overall financial position should have been considered by the lender."

OPTIONS FOR ADDRESSING NON-COMPLIANCE

Options for increasing lender registration requirements

Option A: Expanded powers

We agree it would be helpful if the Commerce Commission could, in limited cases, direct the Companies Office to deregister a lender providing consumer credit. This would be a wide power and we consider that instead of the Commerce Commission being **either** satisfied that the lender is causing **or is likely to cause harm** that the Commerce Commission would need to have evidence of actual harm being caused (for instance through a series of material complaints). We also support the introduction of a new management banning order for persistent breaches of the legislation.

Option B: fit and proper person test

More information is needed. It is unclear what information lenders' directors and senior managers would need to provide to show they are fit and proper persons. If this is simply providing references, we consider this may be of little assistance in ensuring compliance.

Option C: comprehensive creditor licensing

We consider this option is worth exploring, provided the benefit of licensing is likely to outweigh the costs involved.

We expect that most current responsible lenders would be able to satisfy licensing requirements reasonably easily. The very act of applying for a licence could deter would be lenders who do not currently have well documented processes for ensuring compliance with the responsible lending principles. Those that do apply and have insufficient compliance would likely receive guidance from the regulator where 'holes' are identified. This is likely to increase the quality of lending across the board.

We appreciate that comprehensive licensing would take a lot of resource and would require significant investment in setting up a licensing regime through the Financial Markets Authority or the Commerce Commission.

OPTIONS FOR STRENGTHENING ENFORCEMENT AND PENALTIES FOR IRRESPONSIBLE LENDING

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

Although FSCL does not 'penalise' lenders if there have been instances of irresponsible lending, the fact the CCCFA does not give absolute guidance on what action is to be taken if there is a breach, makes it difficult for us in making a decision about the remedies available after a breach.

We usually refer to section 94(1)(b) of the CCCFA which essentially states that a lender should compensate a borrower for the loss or damage resulting from the irresponsible lending. We have interpreted this as meaning that no interest or fees can be charged if there has been irresponsible lending. However, it would be helpful if there were more detailed guidelines around this. It may also encourage consumers and lenders to accept our decisions more frequently if we can point to actual legislation or guidance that underpins our views on remedies.

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

Enforcement Option B: directors' duties

We consider directors' duties should be extended to senior managers. In our experience, it is often senior managers rather than directors who oversee lenders' day-to-day responsible lending decisions.

Enforcement Option C: substantiation for lenders

We do not support this option. If lenders publish their affordability and suitability assessments, we consider it could encourage consumers not being truthful in their applications and in the information they provide the lender, so as to fit within the criteria. We also anticipate lenders will not want their internal processes published, for commercial considerations.

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

Regulatory action helps to clarify the law around responsible lending which is a helpful tool for FSCL when issuing decisions on responsible lending complaints. However, this will necessitate an increase in funding for the Commerce Commission and we anticipate lenders will be reluctant to see further compliance costs added.

We consider it would be helpful if lenders were required to actively refer a borrower to the lender's dispute resolution scheme (DRS) if the borrower has defaulted on their loan within the first three months of the loan being advanced. This is because default within such a short period of time after the loan is granted means there is a higher likelihood the customer could never afford the loan and the lender may have breached its responsible lending obligations. As well as seeking to resolve individual complaints, the DRS would notify the Commerce Commission of any systemic issues identified.

In the same vein, we strongly submit it should be mandatory for lenders to give borrowers the details of the lender's DRS at the time a complaint about any issue is made. It should also be mandatory for lenders to notify clients not only of the ability to apply to court if they

do not agree with the lender's decision on an application to vary the credit contract on the grounds of unforeseen hardship, but also of the ability to contact the lender's DRS. This would necessitate an amendment to section 58 of the CCCFA.

The DRSs are nimbler in resolving disputes about unforeseen hardship applications, and there is no cost to consumers to use a DRS's service. The court system, which is stretched in terms of resources, also benefits if the DRSs deal with complaints about unforeseen hardship applications.

<u>Enforcement Option E: require creditors and their agents to work with consumers' advocates if asked to do so, and in good faith</u>
We think it would be beneficial for lenders to engage more with consumer advocates.

OPTIONS FOR INTRODUCING MORE PRESCRIPTIVE REQUIREMENTS FOR AFFORDABILITY ASSESSMENTS AND ADVERTISING

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

<u>Responsibility Option A: introduce more prescriptive requirements for conducting affordability assessments</u>
We consider that if prescriptive requirements for conducting affordability assessments are to be included in the Code, they should apply to all lenders. Borrowers will then have an expectation about the information a lender will require, whatever type of credit they are seeking. At the end of the day, all lenders have to meet their responsible lending obligations.

With reference to paragraph 280 of MBIE's additional information discussion paper, the suggested list would be information we consider first and second tier lenders should require from their customers in any event.

Prescriptive requirements about affordability would also make it easier for the DRSs to assess whether the lender has gathered enough and adequate information to make lending decisions.

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

Similarly, with reference to paragraph 76 of the discussion document, most documentation to verify the information provided by consumers is correct, is easily obtainable. Most outgoings can be seen from bank statements, and a person's income and rent/mortgage payments can be easily verified. There are also guides in the Workplace Savings guidelines on assessing KiwiSaver withdrawals on the basis of significant financial hardship setting out the average costs for each person in a household in different parts of New Zealand. Lenders can utilise such guides in checking that the information provided by a consumer is realistically in line with the consumer's stated living situation.

The requirement to provide verifying information to lenders may deter some consumers from seeking credit (especially HCL loans). However, if the credit is an absolute necessity, we would expect consumers would be able to provide this information.

Issue 3: Continued predatory behaviour by mobile traders

We continue to receive complaints about mobile traders. However, few of these become actual investigation files. Most are able to be resolved internally upon us referring the complaint back to the lender's internal complaint process. We have noticed a drop in complaint volumes about mobile traders following the Commerce Commission's enforcement work in relation to mobile traders in recent years.

Question 15: Which options for changes to cover additional credit contracts would you support? Which would you not support? Please explain how you made your assessment?

OPTIONS TO ADDRESS CREDIT SALES FALLING OUTSIDE THE CCCFA

We consider option B has merit – to prohibit the price of goods or services sold on credit from exceeding the cash price. We are of the view this would force lenders to disclose their interest rate, which may be a better consumer deterrent than the status quo (being that consumers enter into contracts where the stated price of goods is well in excess of the price in retail stores).

A problem with option B is that it may be difficult to judge what the cash price of the goods should be. Is this a comparison between what a person could purchase the goods for at a mainstream store, for example Harvey Norman or JB Hi Fi? Will the lender be required to show that they, say, took the average of cash prices from three different mainstream stores to justify the lender's cash price?

Issue 4: Unreasonable fees

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

FSCL has not yet had to fully investigate a complaint where it has been necessary to conduct a *Sportzone/MTF* analysis of the reasonableness of a fee. We anticipate this would be a difficult task to undertake and may require us seeking expert accounting assistance.

Option B has the advantage that it would be easier for the DRSs in their work investigating complaints about credit fees, if there were fee caps set by regulations or by the Commerce Commission. Consumers and their advocates would also be more easily able to identify where a fee may be unreasonable (and refer a complaint to the DRS), if fee caps were set out in the legislation. However, there is a risk that if fees are capped, lenders will simply charge fees up to the amount of the cap.

We therefore support option A (being essentially the status quo), but note that if fee caps are introduced they should apply to all lenders.

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

POTENTIAL FOR TIGHTENING REGULATION OF THIRD-PARTY FEES

We do, from time to time, see third-party fees added to loans that appear to duplicate lender's fees. In our 2016 submissions to the Commerce Commission about the draft consumer credit fees guidelines we highlighted this issue:

<u>Broker fees and establishment fees</u>

From our experience investigating complaints about car loans, a consumer will attend at a car yard and the car yard's salesperson will arrange finance for the consumer to fund the car purchase. When the consumer receives the credit contract for perusal and signing, they will have been charged an application fee (essentially an establishment fee), by the lender. Part of the total amount advanced to the consumer will also include an amount to cover a 'brokerage fee', adding to the loan's total cost.

<u>Brokerage fees are not credit fees</u>

Brokerage fees are not a 'third party' fees incurred by the lender and passed onto the consumer at cost. Rather, the brokerage fee is a cost incurred by the consumer and financed in addition to the loan amount and other upfront fees/costs.

On the face of it, our view is that broker fees are not credit fees and not subject to the CCCFA. However, this is only if the customer has been in receipt of a true broking service, where the broker has acted as the consumer's agent to seek the best loan for that consumer from the market, or from a number of lenders to whom the broker is aligned. The amount of the brokerage fee will be an amount agreed upon and provided for in the contract between the broker and the consumer. The consumer then, in effect, asks the lender to finance the brokerage fee as part of the consumer's overall loan.

No true broking service provided

However, we often find that car yard salespeople who receive brokerage fees, do not actually provide a true broking service. The salesperson will only discuss seeking a loan from one particular lender (that lender often being closely associated with the car yard and often on the same premises). Moreover, the amount charged as a brokerage fee in these situations can be very high, especially when the consumer will also likely be charged an establishment fee by the lender.

The salesperson may gather information from the consumer on behalf of the lender, which the lender then relies on in carrying out its responsible lending obligations (for example, that the consumer can afford the loan without suffering hardship). However, in our view, it is likely that, in these cases, consumers are effectively being charged two establishment fees.

Example

Attached as appendix 2 is an email we received in September 2016 (we have redacted all identifying information). As the complainant has noted, it appears she was only ever given the option to seek finance from one lender by the car yard's salesperson, and was charged a brokerage fee of $595. The lender also charged an application fee of $245.

We did not need to complete an investigation of this complaint, because the lender resolved the complaint directly with the consumer following our referral of the complaint. However, on the face of it, it appears this consumer was in effect charged an $840 establishment fee, which would appear to be an unreasonable amount to establish a loan of the nature the consumer describes.

Submission

We submit that Code section 10 could be enhanced by adding a paragraph stating that, where a brokerage fee has been charged but a true broking service has not been provided, the consumer may have effectively been charged two establishment fees. This indicates the lender has charged unreasonable credit fees.

Issue 5: Irresponsible debt collection practices

We have investigated relatively few complaints about debt collectors. This is primarily due to the fact that in most cases we see, the debt collector has not actually purchased the debt. In those cases, we refer the complaint back to the underlying lender to resolve.

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

We support option A (key information to be shared with debtor), and option D (making all debt collectors subject to the CCCFA). Under option A, we consider there should be an additional requirement that the debt collector advises the consumer in the disclosure documentation of the details of the DRS to contact if there is a dispute about the debt.

However, if option D was not the preferred option, we would support a varied version of option B – being that the debt collector is required to refer the consumer back to the underlying lender to undergo an affordability assessment and to see whether a reasonable repayment plan could be reached. It should be the actual lender that conducts an affordability assessment because the lender carries the responsible lending obligations, not the lender's agent.

Other issues

Question 26: Are you seeing harm from loans to small businesses, retail investors or family trusts as a result of them not being regulated under the CCCFA?

Question 27: Do you think small businesses, retail investors or family trusts should have the same or similar protections to consumers under the CCCFA? Please explain why/why not.

We strongly support small business, investment, and family trust loans being afforded CCCFA protections. We have seen a few examples of complaints where the loan is for a small business and the complainant business is in essentially the same position as a consumer under a consumer credit contract. We define a small business as 19 employees or less.

People with complaints about small business, investment, and family trust loans can access FSCL's assistance in resolving disputes. We consider the same underlying policy reason for these types of complaints being considered by FSCL, would apply to extending CCCFA protections.

Many family homes are owned by family trusts, and we can see no legitimate policy reason to exclude these from responsible lending protection. The same can be said for 'Mum and Dad' investors who borrow to buy an investment property.

In a complaint we are currently investigating, a woman took out an $80,000 loan to buy and renovate an investment property. Later, the lender granted the woman further advances of $13,000 and $6,000, even though the woman had already defaulted in payments towards the original advance. There were no affordability checks under CCCFA section 9C(3)(a)(ii) or checks that the woman was aware of the full implications of the further advances under CCCFA 9C(3)(b), when the further advances were granted. However, because the loan was not a consumer credit contract, we could not consider responsible lending issues.

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

Section 83J of the CCCFA

Under section 83J, a creditor or creditor's agent cannot take enforcement action in relation to consumer goods if the debtor has made a complaint in relation to any enforcement action and that complaint has not been resolved. Effectively, a complaint is not 'resolved' until the complaint has been investigated and settled or otherwise determined in accordance with the scheme's rules.

We consider this section to be unfair on lenders. We investigate a number of lending complaints where there is no merit, and the repossession and sale of a security item (usually a motor vehicle) is in both parties' best interests to crystallise the debt. However, complainants can abuse FSCL's process by taking the complaint right to the end of FSCL's process (where a determination is made). This delays the inevitable, and means that both parties' positions are deteriorating for another calendar month after FSCL's initial view is issued.

We consider section 83J should be amended to give the DRSs discretion to allow a lender to take enforcement action before a determination is made, if the DRS considers this is in both parties' best interests.

Thank you for the opportunity to make submissions on the review of the CCCFA. We have included in appendix three a summary of our key submissions. If you have any questions, please contact us.

Yours sincerely

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Chief Executive Officer	**Case Manager**