Submission on discussion document: Consumer Credit Regulation Review

Your name and organisation

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Organisation	N/A I was Chief Adviser, CCCFA employed by the Commerce Commission for eight years from February 2008 to February 2016

Responses to discussion document questions

Regarding the excessive cost of some consumer credit agreements

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?
	Problem debt is (by definition) the problem. This is not solely related to high-cost lending. Problems remains with other debt, for instance vehicle finance. In my opinion and experience, vehicle debt amongst lower socio-economic people can be more problematic than payday lending as the loans are much larger and much more prevalent. The loans are much more common, and while interest rates of 25%-35%pa are lower than payday lenders, the amount of interest/fees involved are much, much larger. It stands to reason that if someone is struggling to repay a $200 loan then repaying a $20,000 loan is much more onerous. I support a cap on interest and fees. However I don't think it should be restricted to "high cost lending (to be defined)". I think it should be applied to all consumer borrowing, and I think that total repayments (including principal, interest and fees) should be limited to 2.5 times the loan principal. This would address the problems arising from vehicle loans to vulnerable consumers. In terms of Option B, I support a prohibition on default interest on high cost loans. In my opinion, risk of default is inherently built into the interest rate. This is the position more or less in the Le Pou case. I don't support Option C (setting an interest rate cap). The issue is not the rate at all. Interest on a one-week loan of $100 at 520% pa is only $10. The issue is the impact of compounding. Albert Einstein reportedly said "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it." Therefore, limiting the interest rate is not addressing the problem.
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?

	[Insert response here]
3	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? 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?
	[Insert response here]
4	Do you have any suggestions for the design of options for capping interest and fees? If so, what would be the impact of your proposed design on borrowers, lenders and the credit markets?
	[Insert response here]
5	Which interest rate cap options, if any, would you prefer? Which interest rate options would you not support? Please explain how you made your assessment.
	[Insert response here]

Regarding continued irresponsible lending and other non-compliance

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?
	[Insert response here]
7	If there are to be more prescriptive requirements for conducting affordability assessments, what types of lenders or loans should these apply to?
	[Insert response here]
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?
	[Insert response here]
9	Do you consider there should be any changes to the current advertising requirements in the Responsible Lending Code? If so, what would be the impact of those changes on borrowers,

	lenders and the credit markets?
	Yes. I believe that the advertising requirements in the Responsible Lending Code should be beefed up and include some of the restrictions on advertising imposed in the UK. This includes a restriction on advertising aimed at or designed to appeal to children; and a restriction on the advertising relating to the purpose of loans eg. palm trees (holidays), fancy shoes, etc. The intended result would be to reduce the "normalisation" of using debt for consumer wants. If the restrictions achieved their purpose, they could result in some reduction in borrowing which would impact lenders.
10	Do you agree with our assessment of the costs and benefits of the options to reduce irresponsible lending and other non-compliance? 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?
	[Insert response here]
11	Do you have any suggestions for the design of options for reducing irresponsible lending and other non-compliance? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
	A further option for breach of the responsible lending provisions is to make a breach a criminal offence. The advantage of this is that the Commerce Commission could take action in a case combined with other breaches (eg. disclosure, fees) and all matters would be dealt with in the same court at the same time. This is because there is a problem if a case involves some offences which are criminal and other matters which are civil - the Commission will take the criminal case first, and then the civil case only after the criminal case is completed. This is a very long process (refer Budget Loans, for example). The disadvantage is obviously that a criminal case has a "beyond reasonable doubt" standard of proof which is problematic for a relatively subjective matter such as the responsible lending provisions.
12	Which options for reducing irresponsible lending and other non-compliance would you support? Which would you not support? Please explain how you made your assessment.
	The key concern that needs addressing is that barriers to entry to set up as a creditor (particularly a mobile trader) are so low and the level of non-compliance in that particular area of the market is so high, there needs to be some test to ensure market participants are aware of their obligations and have processes in place to comply with the law. I support the implementation of a fit and proper person registration test (taking into account that a number of lenders who are NBDTs already follow this test as a condition of their RBNZ licence). Registered participants would need to have to disclose their registered people on their loan documents; and there would need to be an appropriate sanction for creditors who have not registered and included details on their documentation. I think the outcome from a comprehensive licensing system would be a good thing, but I have seen the work involved in MIS licensing, and the compliance costs involved in this are huge. I don't think Registration Option A - changing the banning process would have any impact.

I support Enforcement Option C – substantiation
I support Enforcement Option D – industry levy
I support Enforcement Option E – requiring creditors to work with consumers' advocates if asked.

Regarding continued predatory behaviour by mobile traders

13 Do you agree with our assessment of the costs and benefits of the options for covering additional credit contracts under the CCCFA? 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?

Before considering options for covering additional credit contracts, I think you need to reassess the contracts that are currently covered (or not), and how they are covered, including:

- **Layby sales**. Layby sales are defined in s36B of the FTA with the key point "the consumer will not take possession of the goods until all or a specified portion of the total price of the goods has been paid". This is a messy definition, as it mixes up some transactions which are credit (under a normal definition) and some which are not. If a seller retains possession until the goods are paid in full, there is no credit arrangement. The definition of a layby needs to change to delete the words "or a specified portion". This would clarify the situation between laybys and credit contracts. It would be clear that laybys don't include any aspect of credit and therefore fall under the FTA, while any arrangements that have an aspect of credit (ie. debt, because the purchaser has taken possession of the goods and still owes for them) fall under the CCCFA (whether as credit contracts or consumer credit contracts, depending on their nature). Another aspect that could be considered is fees charged on layby sales. To further clearly delineate between laybys and credit contracts, fees on laybys (other than cancellation fees) could be prohibited.

- **Pawn contracts.** Pawn contracts have been mostly excluded by the last changes to the CCCFA, but still need considering separately as some provisions still apply and others may deliberately or inadvertently be imposed. Pawn contracts currently have to disclose the redemption price at 90 days under the SDP Act (and many show redemption prices at 30 and 60 days). However many pawn contracts morph into a hybrid contract after 90 days, effectively a secured loan but where the pawnbroker holds the security. The pawnbroker doesn't exercise their right (but not obligation) to sell the goods (whether because the customer makes undertakings they will shortly redeem the item; or whether it doesn't suit the pawnbroker eg the price of gold is increasing) and the loan arrangement continues in that the pawnbroker charges further "interest". One option to clearly distinguish between pawn contracts and loans is to separately provide that interest on pawn contracts can only be charged for 90 days. This would be particularly useful to provide clarity in the Tongan lending market where security is often provided over tapa.

- **Consumer leases**. The current disclosure provisions need to be changed and improved. My research a couple of years ago was that Australia didn't have the same problems with mobile traders that NZ did. While they had the same issue of overpriced goods being sold to vulnerable consumers, the methodology involved differed. The transactions in Australia were the on-going rent/lease of items such as tablets, cellphones, speakers etc. Therefore, in terms of getting ahead of the game, s16 and Schedules 1 and 2 of the CCCFA need to be reviewed. Section 16 requires that leases be treated as consumer credit contracts – which means disclosure following Schedule 1 is required. However this is counter-intuitive when it is Schedule 2 which sets out relevant information to be disclosed for a lease. A lot of the information set out in section 1 is not all relevant to leases, while other information required by Schedule 2 (such as the cash price) is. Given your Option B, it may also be appropriate that the implied interest rate in a consumer lease should be disclosed in Schedule 2.

14	Do you have any suggestions for the design of options for covering additional credit contracts under the CCCFA? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
	[Insert response here]
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.
	I do not support Option A. ie changing the definition of a consumer credit contract to include any credit contract charging a default fee. I think this would be far too wide and capture a much wider group of contracts than would be initially envisaged. For instance, many subscription services (eg. Sky TV) have a minimum term, and therefore would be regarded as credit contracts. When you look at s6(c) of the CCCFA, there is a huge range of contracts that could potentially be captured (private school fees, optometrists, dentists/orthodontists, funeral services, golf/sports clubs/ski passes, retirement village fees). It is even arguable that some utilities would fall under the definition, especially some phone contracts. Many of these agreements may have a default fee, but to then assume that because of this they are consumer credit contracts and need to provide CCCFA disclosure and go through responsible lending provisions is simply too onerous and would hinder normal business. Presumably if the definition of a consumer credit contract was widened, there would also need to be a change to the definition of credit contract in the FSP Act – would that mean that the dentists, optometrists, Sky TB, schools, golf clubs etc would have to register with a dispute resolution scheme? How would that work given some sectors (eg. retirement villages, telcos) have their own, existing dispute resolution processes? I have reservations about Option B. Fair market value is subjective. The price of a can of soft-drink might differ from 89c to $5.50 or more, depending on whether you buy it from Pak N Save, Four Square, a service station, a bar, a concert venue, or the top of Mt Ruapehu. With such a wide variation in possible prices, how do you then determine fair market value? And how do you determine value for a product that is imported exclusively by the seller or is badged for that seller and is not the same brand as other products sold here? The inclusion of a cash price in the contract could also confuse purchasers. One of the ways that I think the law could be changed to help protect purchasers using mobile traders is to change the CCCFA cancellation provisions for purchasers who have not yet received the goods. This goes back to consideration of a purchaser's rights when

compared with a normal definition of credit. While the purchaser is going through the "deposit building" phase of their purchase, they have not yet received any "credit". Therefore, they should be able to cancel the contract using CCCFA cancellation provisions. Currently many mobile traders do allow a contractual right of cancellation, but the cancellation fees are very high. Under the CCCFA, fees have to be reasonable, but the cancellation fees are often based on a business model that involves very high commissions paid to salespeople which are not recoverable. (This is one of the perverse impacts of fees being based on costs – there is no incentive to minimise costs if they can be recovered directly from borrowers – see below). My solution is that purchasers should have a right of cancellation under section 27 CCCFA up to the time they receive the goods. The fee that would be chargeable would be under section 30 of the CCCFA, although s30(2)(a)(ii) would need to be changed to make it clear that the fee that is chargeable relates to the establishment and cancellation of the credit contract rather than the sale off the goods "any reasonable expenses necessarily incurred by the creditor in connection with the <u>establishment of the credit</u> contract and the cancellation of the <u>credit</u> contract" and it would need to be made clear that the costs relates to actual credit contract (ie. documentation, credit checks),

Another way that I think the law could be changed to help protect purchasers using mobile traders is to change s48 CCCFA that relates to the overpayment of amounts owed. The current section is unworkable. I recollect that part of the problem is the wording "…*by virtue of this Act, the creditor is not entitled to receive*…". Obviously, on some occasions, borrowers want to get ahead of payments, or put a revolving credit account in credit, and you wouldn't want to inconvenience borrowers who have deliberately paid in advance. But the current wording does not assist enforcement where loans have been overpaid, particularly in relation to mobile traders. In those cases, there is often an obscure clause within the contract that gives the lender the right to continue to collect payments from the borrower. Therefore, the payments become payments "the creditor is entitled to receive".
Another partial solution could be to prohibit fees being charged on refunds of overpayments.

Regarding unreasonable fees

16	If prescribed fee caps were introduced, who should they apply to, and what process and criteria should be used to set them?
	If fee caps were to be introduced, they should be introduced across the board. Establishment fees could be charged on a percentage of loan basis. This may not be cost reflective, but has some logic to borrowers (and lenders). One method of fee setting is to state that a fee of or below $x will not result in the Commerce Commission taking enforcement action. If lenders wanted to charge higher fees, they could do so if they could justify them and were prepared to face possible investigation/enforcement action. This was the approach taken by the Commission in relation to credit card default fees in about 2011. The investigation was resolved when the Commission stated that fees under $15 would not attract enforcement attention. The result was to standardise the fee at the bright-line test. We can't say whether $15 was "right" or not, but it achieved a quick reduction in fees charged by some banks, provided certainty and comparability, and saved compliance costs for the banks who no longer needed to justify that

	particular fee. A long consultation process will result in fees that don't end up satisfying any party, and if they are too high they won't work to meet objectives of limiting impact on borrowers and ensuring the cost of finance can be easily compared. So they may as well be set arbitrarily, quickly. I suggest $15 for a default fee and an establishment fee of 1%-1.5% of loan principal, capped at (say) $250 for loans under a set amount (say $20,000) and capped at (say) $1,500 for loans over that.
17	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? 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?
	Option A – substantiation. I disagree with your statement that there will be additional compliance costs. Fee setting based on cost is already a time consuming process and for those that are doing it properly I can't see any additional cost. Option B – fee caps. There is an additional benefit which is a significant decrease in compliance costs for lenders. If you deleted all the "reasonable fee" provisions, and just imposed bright-line tests, lenders would not have to engage legal/accounting advice and take management time to go through the time and expense of a fee setting process.
18	Do you have any suggestions for the design of options for reducing unreasonable fees? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
	The "reasonable fees provisions" are fundamentally flawed and need to be scrapped. One of the purposes of the CCCFA is to "promote and facilitate the fair, efficient and transparent markets for credit" Fees based on the recovery of cost are, by definition, inefficient and provide no incentive for lenders to act efficiently and reduce costs. In fact, the absolute opposite as ineffective and unnecessarily incurred costs can still be recovered. The current plethora of types and amounts of fees distort the comparability of consumer credit contracts, and make the costs opaque for someone like me who is professionally qualified with considerable experience in reviewing credit contracts. Comparability is therefore unfathomable for the general public or vulnerable consumers. Fees are also extremely difficult, time consuming and costly to enforce by the Commission and the fee setting process provides significant uncertainty for lenders which also undermines efficiency and fairness. Given all this - the current fee provisions are an epic fail on all counts of fairness, efficiency and transparency. Another purpose of the CCCFA is to provide rules about credit fees and default fees. This is another fail - they don't. The MTF case took 9 years, went to the Supreme Court, and cost millions of dollars. It wouldn't have been needed if the CCCFA provided appropriate rules. Even after the judgment, the "rules" are still hazy and the Act doesn't provide them.

	I believe that the best approach is to apply some prescription. Set bright-line tests. Make it easy for lenders to comply, for borrowers to be able to compare options, and for the Commission to be able to enforce the law. As above, I suggest $15 for a missed payment (default) fee and an establishment fee of 1%-1.5% of loan principal, capped at (say) $250 for loans under a set amount (say $20,000) and capped at (say) $1,500 for loans over that. Allow the cost of a PPSR registration/Motocheck search fee etc on top. Fees related to repossession could still be imposed. But get rid of the monthly admin fee, variation fee, the reminder fees (charged when the lender tells the borrower they are in default, which is in addition to the missed payment fee), statement fees, etc etc etc
19	Which options for changes to fees regulation would you support? Which would you not support? Please explain how you made your assessment.
	I support option B. As stated above, the current fees provisions do not meet the CCCFA objectives, so Option A alone is not going to work.
20	Have you seen issues with excessive broker fees, or other unavoidable fees charged by third parties, being added to the loan? 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?
	Yes I have seen issues with excessive brokers fees. One thing that could assist is to require brokers to specify clearly and prominently in their advertising or on their websites that they are brokers, and are not direct lenders, and what their fees are and who will pay them. Part of the problem for consumers is that they might not realise they will be charged a broker fee as they have applied via a website advertising loans, and don't realise that they have contacted a middle-man. A second problem is that there is a large sector of the market who are used to brokers being "free" because brokers acting in the bank home lending market don't charge the borrower directly. Therefore a broker fee is unexpected. Disclosure may come at a small additional cost to brokers, but in my opinion, some of the current broker are not particularly forthcoming about their role. If you look hard enough you may find a reference on the website to them being a broker, but it is not prominent. This therefore defeats the objectives of section 9K of the CCCFA I have not considered whether the fees themselves should be regulated, and if so how. There are third party fees other than brokers fees, so any regulation would have to avoid unintended consequences. However, many lenders find it highly unjust that there is no regulation of brokers fees when there is legislation restricting lenders fees, and essentially they perform similar functions (consideration of the loan) and both charge the borrower for their services.

Regarding irresponsible debt collection practices

21	Is this an accurate picture of the problems for consumers experiencing debt collection? Do you have information that confirms or refutes these issues, or sheds light on how widespread or severe they are?
	I disagree with your assertion that "debt collection for consumer credit contracts is currently regulated by the CCCFA." I would say debt collection is currently generally unregulated, and that the Commerce Commission attempts to bring some aspects within the ambit of its regulation by applying the Fair Trading Act where it can.
22	What information should be provided to borrowers by debt collectors? When and how should this information be provided?
	Some information is already required to be provided to borrowers, if the debt collector takes an assignment of the debt, per s26A. I agree that it would be good to include a copy of the original credit contract and I think continuing disclosure statements for all loans while collection is continuing is a good idea. I recall an argument advanced by some lender parties that none was required either because "the contract" per s18 no longer existed (because the term had expired; and the recovery action was distinguishable), or because per s21 the lender had "written off" the loan (on their books) and therefore the obligation for continuing disclosure ceased – the residual collection by the debt collector didn't count as debits/credits. It may therefore be useful to specify when the contract ends, and whether obligations continue over the full life, from establishment to final repayment or write off (however effected). Information should be provided on the transfer of a debt, as currently, and then ongoing continuous disclosure should be made 6 monthly thereafter. The same timeframes should apply to agency collections. Note that often there may be several transfers and debts are repeatedly on-sold from collector to collector – this needs to be factored in to any law change so that borrowers have full information of the changes to their contracts.
23	Do you agree with our assessment of the costs and benefits of the options for addressing irresponsible debt collection? 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?
	[Insert response here]
24	Do you have any suggestions for the design of options for addressing irresponsible debt collection? In particular, what is an appropriate frequency of contact with debtors before (and then after) a payment arrangement is entered into? Please state the likely impact of your proposed options on borrowers, lenders and the credit market.
	[Insert response here]
25	Which options for changes to the regulation of debt collection would you support? Which would you not support? Please explain how you made your assessment.

I support the suggestion of requiring debt collectors to be registered on the FSPR and be members of a financial disputes resolution scheme. It is incongruous that the channel for resolving issues about conduct relating to a loan disappears at a time when borrowers potentially need it most.
I support the specification of appropriate limits on contact between debt collectors and borrowers.
I support changes to the fee recovery model for external debt collectors. As I stated previously, the fees provisions in the CCCFA based on cost recovery provide no incentive for lenders to contain costs. Debt collection fees are significantly higher in NZ than in Australia. Some method of limiting fees is required.

Regarding other issues

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?
	[Insert response here]
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.
	Yes, I believe that loans to family trusts and loans for business purposes where the security the family home should be covered by some aspects of the CCCFA. NZ has very high usage of family trusts, and most small businesses require the family home to be used as security for loans. I think the disclosure, interest and fees provisions should apply. I am less certain about the responsible lending requirements because of the impact this might have on the underlying business purpose. I don't think the CCCFA should apply to general small business lending, property investment, etc where the family home is not involved.
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?
	There are some issues in the Insolvency Act which also impact on debts/security and the way they are dealt with by lenders. Section 243-244 of the Insolvency Act sets out secured creditors' options when dealing with a bankrupt. The creditor can either realise the security or surrender the security over the goods and then prove as an unsecured creditor. The process is set out including time frames and default options. However, there is no similar situation in the section that relates to No Asset Procedure. Therefore, borrowers who had secured loans (including some credit cards) are left in limbo – there is no way to force the lender to exercise its rights in terms of security (if any is genuinely held) and the loans are therefore treated as being <u>outside</u> NAP (which in my opinion is not correct). Therefore, a similar requirement to force creditors to make an election as to how they will deal with secured loans is required in the NAP section.

Any other comments

We welcome any other comments that you may have.

All lenders entering into consumer credit contracts should be required to be registered on the FSPR – currently s8A of the FSP Act means that an off-shore provider lending into NZ (eg. via a website) is not required to be registered in NZ if they don't have a place of business here. By setting this requirement in the CCCFA, s8A(c) of the FSP Act would be triggered.

The CCCFA should incorporate the fair dealing provisions from the FTA and the FMCA. There is some commentary about changing the CCCFA regulator from the Commerce Commission to the FMA, and it is an issue that has cropped up a couple of times previously. Certainly it would be more consistent with ASIC if the CCCFA was enforced by the FMA. However one of the key reasons for keeping enforcement at the Commerce Commission has been the way that the FTA is often used in enforcement. Therefore, to future-proof the CCCFA (and to make it consistent with the FMCA), the fair dealing provisions from the FTA should be incorporated in the CCCFA.