Review of the Operation of the Credit Contracts and Consumer Finance Act 2003

SEPTEMBER 2009

MINISTRY OF CONSUMER AFFAIRS
MANATŪ KAIHOKOHOKO

New Zealand Government

Review of the Operation of the Credit Contracts and Consumer Finance Act 2003

September 2009

ISBN Print: 978-0-478-33677-1
PDF: 978-0-478-33678-8
Ministry of Consumer Affairs
PO Box 1473
Wellington
New Zealand

Disclaimer

The opinions and proposals in this discussion document are those of the Ministry of Consumer Affairs and do not reflect government policy.

Readers are advised to seek specific legal advice from a qualified professional before undertaking any action in reliance on the contents of this discussion document. The contents of this paper must not be construed as legal advice. The Ministry does not accept any responsibility or liability whatsoever whether in contract, tort, equity or otherwise for any action taken as a result of reading, or reliance placed on the Ministry because of having read, any part, or all, of the information in this document, or for any error, inadequacy, deficiency, flaw or omission from this document.

List of Contents

Foreword

Credit is an important part of New Zealand's economy as it provides flexibility for consumers to access goods and services and enables increased participation in the market. However, in the current economic climate, many consumers are facing greater challenges in accessing, using and repaying credit. Care is needed to ensure that consumers continue to have access to credit and are able to use and manage that credit appropriately.

The Credit Contracts and Consumer Finance Act (CCCFA) took effect on 1 April 2005 and regulates all forms of consumer credit. This includes personal loans, credit sales, hire purchases, credit cards, long term leases, mortgages (home loans) and housing buy-back schemes and therefore affects most New Zealanders.

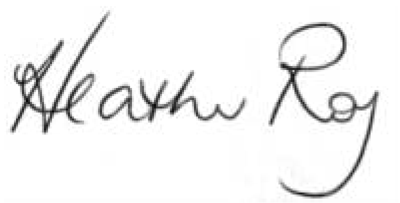
When the CCCFA was introduced it replaced the existing credit legislation and was intended to provide better protections for New Zealand consumers. The underlying goal of the Act is to empower consumers by requiring disclosure of key information on credit contracts.

Along with informing consumers, the Act's information disclosure requirements aim to promote competition, efficiency and good practice in the credit market. The CCCFA also provides lenders with flexibility in setting interest rates and fees.

This period of economic uncertainty provides a timely opportunity to review our consumer credit legislation. The review will enable us to determine whether the CCCFA is delivering good outcomes for New Zealanders now, and whether it will continue to do so into the future.

The discussion document outlines several proposals to amend the CCCFA in order to improve its operation. It also looks at other legislative initiatives that have been or are being introduced in New Zealand and that are likely to affect the operation of our consumer credit market.

I warmly invite your comments on the proposed amendments and wider credit issues.



Hon Heather Roy
Minister of Consumer Affairs

Executive Summary

The Credit Contracts and Consumer Finance Act 2003 (CCCFA) is principle-based legislation providing for disclosure of information to allow consumers to make informed decisions and regulatory protections to mitigate practices that cause consumer detriment, including oppression.

The general principles of the CCCFA are sound and there is a relatively good level of compliance with the Act. Compliance is monitored and enforced by the Commerce Commission.

While the regime is still bedding in, it is generally meeting its objectives.

At the margin, the CCCFA is not achieving its objectives as some borrowers are not benefiting from disclosure, at least in part reflecting a problem of financial literacy.

Poor decision-making by borrowers can have significant consequences, especially for those on low incomes and with little resilience in the face of financial pressures.

Several amended or additional disclosure provisions are proposed for consideration to allow more informed consumer decision-making:

- Not allowing delayed disclosure when purchasing a motor vehicle using credit arranged at the time of purchase (at present disclosure can occur 5 working days after vehicle purchase);
- Providing better information to consumers on mortgage break fees/prepayment;
- Providing clear information to consumers on the implications of not paying off credit card monies owing;
- Providing information to consumers on access to the CCCFA hardship provisions.

Some changes are proposed to improve clarity and enforceability and reduce compliance costs for consumers and businesses:

- Clarification that disclosure requirements also apply to credit insurance;
- Providing for the disclosure requirements in the Secondhand Dealers and Pawnbrokers Act 2004 to satisfy the section 17 and schedule 1 disclosure requirements of the CCCFA;
- Exempting pawnbroking from the prepayment and continuing disclosure provisions of the CCCFA.

The CCCFA allows the separate charging of fees and requires these are not unreasonable. Following some uncertainty about determining fees, the Commerce Commission is developing guidelines for creditors on its enforcement approach to fees. The guidelines will provide useful advice to creditors. Specific amendments to the fees provisions are suggested to clarify that frontloading of fees is not permitted and to extend the timeframe for allowing a claim to the Court, challenging the reasonableness of a fee.

There is some evidence from community organisations that consumers are missing out on accessing the hardship provisions in the CCCFA. To improve access, the following changes to the hardship provisions are proposed:

- Extending the provisions to also allow applications for hardship relief when in default of a credit contract provided the default is less than 2 months duration;

- Defining timeframes for acknowledging (5 working days) and processing (20 working days from receipt) of a hardship application, and providing for consumers to seek a ruling from the Disputes Tribunal on hardship if the processing timeframe is not met;
- Not allowing penalty fees and penalty interest until a final decision has been made on a hardship application;
- Providing that fees cannot be charged for processing hardship applications.

A practice that appears to encourage excessive indebtedness for some consumers is unprompted or unsolicited extension of credit. To address this issue, it is proposed the CCCFA is amended to not allow the extension of credit provision without a consumer expressly agreeing to the extension (opting-in). Financial providers could still offer credit extensions but consumers would have to make a conscious decision to accept the new credit provision.

Another area of concern is repossession of goods following default of a credit contract. This seems to be related to overly broad security clauses in credit contracts. One way to address this issue is to require itemised disclosure or other sufficient description of any property over which the creditor has a security interest in the credit contract and Credit (Repossession) Act pre-possession notice.

Concerns have been raised about creditors failing to follow the processes set out in the Credit (Repossession) Act. Greater penalties and possibly requiring an independent authority to oversee credit repossessions could improve compliance with the Act.

The CCCFA does not specifically deal with fringe lending practices (practices engaged in by credit providers that entice typically low income consumers with low levels of financial literacy to take on excessive interest or fees). However, the proposals contained in this discussion paper, in combination with a number of government initiatives that have been taken or are in train, will enhance consumer confidence in the financial sector and consumers' ability to seek redress regarding credit contract transactions that go wrong. These initiatives include:

- The increase in the limits for claims to the Disputes Tribunal which are now $15,000 or $20,000 with the agreement of both parties;
- Compulsory registration and a requirement for all financial service providers to belong to consumer dispute resolution (that must be accessible and free to consumers);
- Consideration of adding to the Fair Trading Act 1986 a specific prohibition relating to unfair contract terms in standard form contracts.

1. Introduction

Borrowing is a common occurrence in the daily lives of consumers. It helps stimulate economic activity by allowing flexibility in how consumers choose to engage in the market place, how they manage their finances and by broadly allowing resources to be put to their most efficient use. Access to credit enables consumers to manage the purchase of high cost items such as homes, vehicles and large appliances. It also enables consumers to respond to unexpected events, such as funeral expenses, broken appliances and vet bills.

The law related to borrowing and lending is the Credit Contracts and Consumer Finance Act 2003 (CCCFA). This Act came into effect on 1 April 2005, building on and replacing existing credit law. The CCCFA was developed with five key policy goals and when enacted it was described as being strong, innovative legislation designed to better protect New Zealand consumers. It covers all forms of credit provided to consumers for personal, domestic or household purposes and includes home loans, personal loans, credit sales, hire purchase, student loans, credit cards, long-term leases and housing buy-back schemes.

The underlying policy goals of the CCCFA are to:

- promote an efficient consumer credit market;
- provide effective information for borrowers to determine the cost/benefits of a loan;
- give lenders flexibility in pricing;
- establish compliance incentives for borrowers and lenders; and
- actively discourage oppressive conduct.

A fundamental principle in the Act is that decisions to borrow will be made by individuals in a rational manner fully taking into account available information. The Act is also principle-based rather than prescriptive allowing for flexibility and innovation.

These policy goals are reflected in the Act's purposes statement and are underpinned by its key features.

Purposes Statement

- *to protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land; and*
- *to provide for the disclosure of adequate information to consumers under consumer credit contracts and consumer leases—*
  - *to enable consumers to distinguish between competing credit arrangements or competing lease arrangements; and*
  - *to enable consumers to become informed of the terms of consumer credit contracts or consumer leases before they become irrevocably committed to them; and*
- *to enable consumers to monitor the performance of consumer credit contracts or consumer leases; and*
- *to provide rules about interest charges, fees, and payments in relation to consumer credit contracts; and*
- *to enable consumers to seek reasonable changes to consumer credit contracts on the grounds of unforeseen hardship; and*
- *to provide for the disclosure of adequate information to consumers under buy-back transactions of land and for the provision of independent legal advice to those consumers —*
  - *to inform consumers of the terms, the effects, and the implications of those transactions before they become*

irrevocably committed to them; and

- *to enable consumers to monitor the performance of those transactions; and*

- *to provide rules about fees in relation to buy-back transactions of land; and*
- *to prevent—*
  - *oppressive credit contracts, consumer leases, and buy-back transactions of land; and*
  - *oppressive conduct by creditors under credit contracts, lessors under consumer leases, and transferees under buy-back transactions of land.*

Key features of the CCCFA are:

- disclosure requirements which require all credit arrangements to outline key elements including costs and conditions, what the borrowers' obligations and rights are, and what fees and charges may be applied to the loan and under what circumstances (these requirements are intended to enable borrowers to make an informed decision on whether or not to enter into a particular loan);
- an obligation on lenders not to apply unreasonable fees or charges to loans or to require borrowers to unreasonably take credit related insurance or insurances that provide no benefit to the borrower;
- the ability for borrowers to repay loans early without being subject to unreasonable fees, charges or penalties;
- the ability for borrowers to seek relief in the contract terms when in unforeseen hardship, so long as they are up-to-date with their payments;
- deterrents from oppressive contracts, conditions and behaviour that enable the contracts to be opened by a court and varied to remedy the oppression;
- the ability for parties to the loan to use the Disputes Tribunal in seeking remedies and reparation up to $15,000;
- the Commerce Commission having responsibility to promote compliance with the Act, including functions to monitor trade practices, to undertake enforcement and to provide guidance information in relation to promoting compliance with the Act.

In accordance with good regulatory practice, following three years of operation, the CCCFA has been reviewed. The review has looked at the operation and effectiveness of the legislation and whether it is meeting its intent.

Leading up to the review and in response to concerns identified (particularly about fringe lending), the Ministry of Consumer Affairs commissioned two pieces of work: 2006 *Fringe Lenders in New Zealand Desk Research Project* and the 2007 report, *Pacific Consumers' Behaviour and Experience in Credit Markets, with Particular Reference to the "Fringe Lending" Market,* conducted by Auckland Uniservices.

The *Fringe Lenders Desk Research Project* identified that there were approximately 185 fringe lending companies operating in 2006, 94% of which offered cash or personal loans, 43% car loans, and 26% debt consolidation loans. Fringe lenders' are defined as second-tier (non-bank) lenders providing comparatively small personal loans, with typically less stringent lending criteria than banks. The study also looked at the geographic spread of fringe lending companies identifying that the heaviest concentrations are located in low socio economic areas, including some areas of Manukau City, Otahuhu, North Shore, West Auckland, Lower Hutt, Porirua, Wellington (Newtown) and Christchurch (Riccarton and Sydenham).

This work and concerns from the Pacific Island community prompted the commissioning of the Pacific Consumers' Behaviour and Experience in Credit Markets. This report highlighted many practices being employed by fringe lenders were leading to borrower detriment and could be considered unethical or failed to meet the obligations of the CCCFA. The report also highlighted factors that lead to borrowers taking on excessive levels of debt.

As well, as part of the review, in late 2007 the then Minister of Consumer Affairs, hosted a Financial Summit in Otara. The Summit brought together representatives from community service agencies, community law centres and the major banks. The Summit considered fringe lending activities in particular, discussed lending initiatives being progressed to help those in lending difficulty and identified issues for further consideration that are addressed in this discussion paper.

The review has been undertaken with assistance from the Commerce Commission which is responsible for enforcement of the legislation. The Commerce Commission provided specific input regarding the types of complaints it has received.

Consultation with stakeholders, such as community organisations, banks, the Principal Disputes Tribunal Referee and other financial sector organisations has also provided the review with invaluable information on the CCCFA and wider concerns regarding the provision of credit.

The initial objective of the review was to determine whether the CCCFA is operating efficiently and meeting its original intent. However, given the concerns raised through the *Pacific Consumers' Behaviour and Experience in Credit Market* report, the 2007 Financial Summit and the work with community advocates, the review has looked wider into those issues and potential solutions.

This paper is presented in two parts. Part One focuses on specific discussion of the CCCFA and also parts of the Secondhand Dealers and Pawnbrokers Act 2004 and the Credit (Repossession) Act 1997. It describes the provisions of the Acts and how these are working in practice. Proposed amendments to the CCCFA and also the Credit (Repossession) Act are outlined which aim to improve the overall effectiveness of the legislation. Feedback is sought on these proposals.

Part Two discusses particular concerns with lending practices at the margin, referred to as fringe lending practices. These practices have been identified as having a detrimental effect on borrowers. Government initiatives in train which should help to mitigate some of these practices or their detrimental effects are outlined and also mechanisms in train overseas to address similar problems are discussed.

2. Seeking Your Views

The Ministry of Consumer Affairs invites submissions on the proposals outlined in this discussion paper. To assist your consideration of the issues covered in the discussion paper are a number of questions. These are included throughout the document and listed in full on page 66. Please do not be constrained by these questions or feel that you need to answer any or all of the questions.

Parties who wish to make a submission are invited to respond by Monday 16 November 2009. Please contact the Ministry of Consumer Affairs (cccfa@mca.govt.nz) if you are experiencing difficulties meeting this deadline.

Submissions should be emailed in either Adobe PDF or Microsoft Word format to the Ministry of Consumer Affairs (cccfa@mca.govt.nz), with "Submission on the CCCFA" as a subject heading. Alternatively, submitters may send hard copies of their submission to:

James Ryan
Ministry of Consumer Affairs
PO Box 1473, Wellington

Submitters should indicate any documents attached in support of their submission in a covering letter. The Ministry of Consumer Affairs will acknowledge receipt of all submissions electronically. Please contact James Ryan at cccfa@mca.govt.nz or ph +64 4 474 2845 if you do not receive electronic acknowledgement of your submission within 5 business days.

Consideration of submissions

The Ministry of Consumer Affairs will consider all submissions and, then taking these into account, will make recommendations to the Minister of Consumer Affairs on any amendments to the Credit Contracts and Consumer Finance Act 2003 and the Credit (Repossession) Act 1997.

Official Information Act 1982

Please note that any submissions you make may be published and subject to a request for release under the Official Information Act 1982.

In providing your submission, please advise us if you have any objections to the release of all or part of your submission and the basis of your objection. When preparing and releasing any summary of submissions and when considering any Official Information Act requests, the Ministry will carefully review any representations you make in this regard.

Privacy Act 1993

Any personal information that you supply to the Ministry in the course of making a submission will be used only by the Ministry when considering matters covered by this discussion paper.

When preparing any summary of submissions on Ministry discussion papers, it is the Ministry's normal practice to set out the names of parties making submissions. Your name will be included in any such summary unless you inform the Ministry that you do not wish your name to be included. To indicate your wishes, or to view personal information held about you in relation to matters covered by this discussion paper, or to request correction of that information, please contact the Ministry of Consumer Affairs (cccfa@mca.govt.nz).

Part One: Review of the Operation of the Credit Contracts and Consumer Finance Act 2003

3. Information Disclosure

Background

The CCCFA has particular emphasis on disclosure of information to consumers. One of the stated purposes of the Act, section 3(b), is to provide consumers (borrowers) with adequate information under consumer credit contracts and consumer leases to enable borrowers to:

- distinguish between competing credit arrangements or competing lease arrangements; and
- become informed of the terms of consumer credit contracts or consumer leases before they become irrevocably committed to them; and
- monitor the performance of consumer credit contracts or consumer leases.

While disclosure was required in the previous Credit Contracts Act 1981, the CCCFA requirements are significantly different and require more transparency about interest rates, charges, fees payable and the terms and conditions of credit contracts. The Credit Contracts Act required disclosure of the "finance rate" for a loan which was intended to provide a standardised measure of the credit's cost, combining interest and charges, that could be used by borrowers to compare loans. The Ministry of Consumer Affairs 1999 review of the Credit Contracts Act identified multiple criticisms of the "finance rate" concept which reduced its value as a source of information for consumers[1].

The disclosure requirements in the CCCFA are intended to address the issues identified with the previous regime and to provide more robust and transparent information to borrowers. The provision of the annual interest rate and a clear itemisation of fees and charges applicable to a loan are intended to enable the borrower to more objectively consider loan offerings and their suitability.

A benefit of separating credit fees and charges from the interest rate is that it enables good information to be provided for revolving credit arrangements and for the advertising of interest rates. Interest rate advertising has been particularly important in the mortgage market and, as a whole, it can be argued the transparency required by the CCCFA has promoted market competition (certainly for mortgages and credit cards). Another benefit is that information on the credit contract's status (such as money owing, time period remaining) can now be more easily provided to borrowers.

The precise information required to be disclosed for different loan types is set out in schedules 1 to 3 of the Act (Schedule 1 – consumer credit contracts; Schedule 2 – consumer leases; and Schedule 3 – buy-back transactions of land). Different information is also required to be disclosed at different times during the loan period as follows:

[1] The criticisms included: imprecise wording for the incorporation of charges, which made judicial interpretation inconsistent and ultimately led to uncertainty; all charges required for a borrower to adequately compare loans from different providers were not provided; a lack of advice to borrowers about how to interpret the "finance rate"; advertising on the basis of "finance rates" was impractical because calculation of the rate relied on multiple factors; that the rate could not be calculated for revolving credit arrangements and therefore the rate was not required to be disclosed; and variable interest rates caused complications that made it difficult to calculate the finance rate accurately.

Initial disclosure - is required at the commencement of a loan. The purpose is to inform the borrower of the key terms and conditions of the contract before the borrower becomes bound by them. Initial disclosure must be provided to the borrower either before entering into the contract or within five working days of entering it. The key information that must be provided includes:

- the annual interest rate;
- credit fees payable, including when they can be applied;
- the amount of known advances under the contract;
- details of payments required.

Continuing disclosure – is required at intervals during all credit contracts (one exception being interest-free credit) and provides the borrower with information on the loan account. This information includes the outstanding amount of the loan (the balance) and the interest charges that have accrued.

The purpose of continuing disclosure is to enable the borrower to monitor the performance of the loan and be clear on what is owed. For revolving credit (credit cards and some mortgages), this disclosure is required at least every 45 working days.

Variation disclosure – is required where the terms of the loan contract are changed. Changes to the contract may be agreed to between the borrower and lender on a mutual basis or when the lender exercises a right under the contract to unilaterally change, for example, the interest rate or fees.

Where a lender exercises a unilateral right under the contract, the lender must inform the borrower before the change takes place or comes into effect.

Request disclosure – is the right borrowers have to request certain information about the loan contract. This right can be used to find out the amount required to repay (full prepayment) the loan.

Guarantor disclosure – is where a contract has been varied for some reason. The lender must provide the loan guarantor with a copy of the key information concerning the contract that they are guarantor for.

How the disclosure provisions are working in practice

In considering whether the CCCFA disclosure provisions are achieving their purpose, the complexity and variety of modern credit products needs to be taken into account.

The premise of the CCCFA's disclosure requirements is based on the general principle that consumers should have access to enough appropriate information to make an informed and intelligent decision about the products and services on offer.

The intent of the Act's disclosure requirements is that the disclosure of information will influence consumers to shop around for the best deal, change their behaviour or refrain from purchasing a particular good or service if the cost of credit is higher than the benefit to be obtained from the credit. Consumers shopping around is intended to drive competition amongst credit providers and result in benefits for consumers, i.e. cheaper credit on better terms.

1. Advertising and "shopping around" for credit based on disclosure

For many of their loan products, mainstream lenders actively promote their interest rates in popular media, such as newspapers, radio and television. Credit cards and personal loans are somewhat different in that interest rates are not as prominently advertised as their convenience and their ability to give a certain lifestyle. Credit cards are sometimes advertised with short-term, low-interest rate offerings when a debt transfer is made from one debt facility to another. This practice is linked to competition and client building.

In contrast are lenders who focus their advertising on gaining custom through emphasising the ease of access to credit, to the extent they advertise as willing to lend to anyone. There is also advertising that suggests the ease of repayment, for example, just 8 percent per week[2] (which as well as ease of payment seems to suggest to the consumer the interest rate is very manageable when in fact it is extremely expensive – 416 percent per year, especially if a long term loan is being sought).

Advertising of interest rates is generally of benefit to consumers as it enables them to compare loan offerings based on interest rates before approaching a particular lender or lenders. For mortgages, this is of particular importance as for larger loans the effect of the interest rate is much more pronounced.

Discussions with community agencies who are familiar with consumer behaviour in the finance sector, have suggested that potential borrowers are unlikely to approach multiple lenders to obtain the disclosure information so they can determine which loan offering best suits their purposes. The noted exceptions are for mortgages and large loans but even then the main driver is the interest rate.

One major lending institution has suggested that a majority of borrowers are only interested in what each repayment will be and for how long they have to maintain it. This lender employs a voluntary practice of walking borrowers through disclosure to assist borrowers to understand the terms of the contract.

Two areas where shopping around is less likely to occur

Motor vehicle finance

One example where consumers are unlikely to shop around for competing finance is when they intend to purchase a motor vehicle using finance. Unlike a mortgage, which the consumer will often shop around for, the consumer shops around for the motor vehicle but not for the finance to pay for it. When the consumer decides to purchase a particular vehicle, the consumer will often go with the finance provider offered by the motor vehicle trader rather than complete a whole new round of shopping around for the finance. In such a situation, the disclosure provided under the credit contract is likely to be of little relevance to the consumer. The consumer has already made a decision to buy the vehicle and is unlikely to be dissuaded by the finance terms. In some instances, the consumer might not even realise that there is the option of sourcing credit elsewhere.

Fringe lending finance

Those using fringe providers also appear less likely to shop around. For instance, by the time a person is in a position of needing to use a fringe lender service, the person is not likely to be concerned with the interest rate or fees and charges as a reason to question whether to enter into

[2] The CCCFA requires disclosure of the annual interest rate but this does not preclude advertising of a weekly rate.

the credit contract or not. It is more likely that the immediate personal circumstances are driving the need for credit.

The reasons identified for using a particular lender (and thus not shopping around using disclosure information) include:

- it is the only lender in the neighbourhood that is willing to lend to the consumer;
- the lender may have been recommended by family or friends who have personal influence;
- there may be a pre-existing relationship with the borrower (or one with a family member);
- following the footsteps of peers;
- there might be a sense that it is easier to get money from fringe lenders than the mainstream banks; or
- the consumer simply believes they cannot access the services of a mainstream lender.

Such reasons mean that the borrower's perceived value of disclosure information is not as important in the decision-making process as compared to their personal circumstances.

Borrowers may also be using acceptance or rejection of a loan application as the means by which they assess whether they can actually afford the loan repayments. The reasoning behind this is that the borrower may assume the lender will not lend the money if the lender does not consider the borrower is capable of repaying the debt. In such situations, the borrower may not realise the lender has other means to recover the debt, such as repossession of security items, and is therefore less concerned about the borrower's ability to repay. At the extreme end, lenders may seek court ordered attachments for wages or benefits to recover debts.

These behaviours are often reported by community agencies as affecting the low income or vulnerable consumer. This was highlighted in the *Pacific Consumers' Behaviour and Experience in Credit Markets* report the Ministry of Consumer Affairs published in 2007.

Overall the advertising of interest rates suggests that the CCCFA has had some effect in promoting competition and transparency, particularly in the mortgage market. For small personal loans, the CCCFA's interest rate disclosure provisions appear to have had a minimal effect in altering consumer behaviour. This may be because smaller loans are not seen as such a major life-long commitment and as such the same level of consideration given to mortgages is not necessary.

Lenders do not appear to compete to any extent on non-interest rate elements they are required to disclose, such as fees and charges. Consumers would also appear not to approach various lenders to obtain other disclosure information to compare. It is possible that the CCCFA's requirement for fees and charges to be reasonable may give consumers the impression that looking at these elements is not worthwhile as they are already regulated for, in other words "the government has already checked this out, it must be safe."

Ultimately, the effectiveness of disclosure is linked to the individual consumer's ability and willingness to use the information provided. Where it is not or cannot be used, then its effectiveness is limited. As financial literacy, awareness and capability increases, the effectiveness and effects of disclosure are also likely to increase.

2. Timing of initial disclosure

As previously noted, the CCCFA requires initial disclosure to be provided when the credit contract is made, or within 5 working days of it being made (section 17). The prior Credit Contracts Act allowed a 15 working day window for initial disclosure.

Monitoring by the Commerce Commission indicates that the time at which initial disclosure is made varies among lenders. The majority, however, provide disclosure at the time the credit contract is made rather than within the 5 day window permitted by the Act.

The ability to provide disclosure within 5 working days of a credit contract being made provides flexibility in accessing and providing credit by enabling a borrower to arrange credit quickly. For example, arrangements may be made over the phone for money to be available immediately rather than having to wait for disclosure to be made. This is of significance for consumers with unexpected needs such as to attend a funeral.

The provision also enables banks to operate without branches and provide consumers with greater access to lending services. For example, it enables consumers purchasing a house at auction to confirm finance arrangements over the phone prior to or at the auction and bid for the house they want.

A mainstream lender has also advised that a significant proportion of applications for credit, including credit cards, overdrafts, extensions of credit and new applications for credit, are made over the phone or by internet. Some banks only operate over the phone and internet. Providing this sort of flexibility to access credit is important in promoting a competitive credit market. It also reflects banks', and other lenders', responsiveness to customer needs by providing credit access at the customer's convenience.

Alongside section 17, the CCCFA requires the initial disclosure to include information on the borrower's right to cancel the contract (section 27). The right to cancel is intended for situations where the contract is found to be unsatisfactory after receiving and reading the disclosure.

To cancel the credit contract the borrower must inform the lender, in writing, within 3 working days of disclosure being made. If disclosure is not provided then the contract can be cancelled at any time. This right, however, does not apply to contracts with a term of less than two months, and where no part of the credit is used to pay amounts owing to the creditor or a related company under another credit contract (as set out in section 29(1)).

To complete the cancellation, section 27 provides that a borrower:

- has to pay the cash price of the property or services (or balance of the cash price) to the creditor within 15 working days after the cancellation notice is given if the consumer has taken possession of the goods and correct disclosure has been made; or
- in any other case, must return any advance and any other property within 3 working days from the day that the disclosure is made.

Consumer groups have advised that the ability to provide disclosure after the fact, in some instances, is not working in the borrower's interest. The examples cited predominately relate to vehicle sales through credit arrangements. The consumer purchasing the vehicle takes on-the-spot finance (through the trader) so the consumer can take the car from the trader immediately. Disclosure is not made at the point the contract is signed. The consumer then takes possession of the car and the motor vehicle trader is paid for the car by the lender (lender and vehicle trader are independent). In this instance, the consumer has entered into two separate contracts, one with the motor vehicle trader for the car and the other with the lender for the money to pay for the car under the first contract.

This situation can become problematic when the disclosure provided differs from the borrower's initial understanding of the terms and conditions of the contract. When the borrower seeks to exercise their right to cancel the credit contract because it was unacceptable, the borrower finds that they are unable to return the vehicle to repay the loan. This is because the motor vehicle trader is under no obligation to accept the vehicle back, unless this right is included in the contract. As far as the vehicle trader is concerned, the vehicle has been purchased and the issue is between the lender and borrower. The lender typically has no interest in taking the vehicle to repay the debt, even though it may be listed as a security item, as the lender is not in the business of selling vehicles.

In this instance, to cancel the credit contract, the borrower must get the money from another source. The borrower will probably have to pay a new round of establishment fees; or accept the unsatisfactory terms of the original finance agreement.

In instances where the borrower cannot maintain the original contract the vehicle may be repossessed as security and be sold to recover the debt. Vehicles sold through this mechanism are typically sold quickly at below retail market value, to free up funds. This can leave the borrower owing the initial amount less the resale value of the vehicle and in many instances this can result in the borrower having to service a debt for which the borrower does not get any benefit (i.e. no car). In many instances the outstanding debt can be thousands of dollars.

These examples have led consumer advocates to suggest that full and up-front disclosure should always be made, at least for vehicle credit.

This would theoretically ensure that the consumer has the means to know exactly what they are signing up to prior to the point they complete the sale and purchase agreement for the vehicle and take it from the trader's lot.

Whether this will result in any benefit for borrowers will depend on their ability to separate themselves from the emotive tie to the vehicle sufficiently enough to read the disclosure and make a rational decision on whether the loan's terms and conditions are acceptable. The actual level of benefit cannot be easily gauged as it is linked to consumer behaviour; however, it does enable the consumer to consider the information prior to completing the contract to buy the vehicle (which is the intention of the CCCFA).

The proposal does have some foreseeable difficulties for lenders and vehicle traders, in that mechanisms will have to be established for the trader to provide disclosure to the customer where the lender is not present to do so. This may result in transactions consuming more of traders' and consumers' time to complete. In certain circumstances, the lender may be delegating their disclosure requirements to vehicle traders.

Arguably, the provision of disclosure and the consumer's right to cancel meets the Act's intent to enable consumers to become informed of the contract's terms before becoming irrevocably committed and to monitor contract performance.

On one hand it can be argued that when purchasing a motor vehicle, the onus of making the best choice of financier resides with the consumer to shop around. Ultimately, if the consumer chooses to go with the finance arranged by the motor vehicle trader and has not considered other options, the timing of disclosure will not benefit them at all.

On the other hand, behavioural factors indicate that this would appear to be an area where there is less shopping around for credit by consumers and that the disclosure of terms and conditions after sale are disadvantaging some consumers unreasonably.

Proposal

On the basis of the above, one option is to amend the CCCFA to provide that when purchasing a motor vehicle from a motor vehicle trader (as defined in the Motor Vehicle Sales Act 2003), and accessing credit at the time of the purchase, the borrower must be provided with the disclosure as required by the CCCFA immediately at the time of sale.

Q.1

- Do you agree that the above option would reduce problems associated with motor vehicle finance?
- What advantages or disadvantages do you see this option provides to consumers and traders?
- Are there other options to address the issue?

3. Use of disclosure as a record of conduct

The disclosure requirements in the CCCFA, while designed to assist consumers in decision making, also have an enforcement benefit. Disclosure serves as a record of representations made to the consumer as part of their credit contract. From an enforcement perspective, disclosure is a document of fact that can be referred to when the credit contract comes into dispute. For example, if fees are not considered reasonable, the disclosure document can be used to challenge the fees as it records details of the terms.

Having such a record means that complaints can be more readily taken to the Disputes Tribunal, the Courts, the Banking Ombudsman or the Insurance and Savings Ombudsman by borrowers should they want to seek redress about a problem.

When undertaking enforcement action, the Commerce Commission may also use what is disclosed as evidence. Disclosure, as a record of lender conduct, can be a vital component in any enforcement action the Commission may choose to undertake. Any statement made in the credit contract may be used as the basis for enforcement action under both the CCCFA and Fair Trading Act 1986.

4. Compliance and enforcement

The understanding, supply and enforcement of the disclosure requirements appears to be relatively straight forward. Disclosure is either:

- made or it is not;
- made within the allowable time or it is not; or
- meets the standard or it does not.

Generally, this means it is relatively easy for the Commerce Commission to take enforcement action: prosecutions, settlements, warnings or giving guidance on compliance. Borrowers may also take issues to the Disputes Tribunal, District Court or High Court, or complaints to the Banking Ombudsman if their issue is with a bank.

Essentially lenders must ensure that disclosure has been made to consumers within the required timeframes and that it is readable. If disclosure has not been made or not made properly then the credit contract cannot be enforced until adequate disclosure is made.

When the CCCFA first came into force the Commerce Commission published two guidance documents - *Credit Contracts and Consumer Finance Act – A general guide for the credit industry* and *Credit Contracts and Consumer Finance Act – What you need to know* – and more generally advised on and monitored disclosure practices.

Where the Commission has investigated alleged breaches of the disclosure requirements, it has found that disclosure has not been provided at all or that it has been lacking in form and substance (i.e. not all the Schedule 1 requirements have been covered).

A recent disclosure case taken by the Commission highlighted the difficulties that the Pacific Island community faces with the use of fringe lenders. The case involved one lender which provided small loans (between $20 and $5,000) and typically held traditional Tongan fine mats and tapa cloths as security.

When the Commerce Commission investigated this fringe lender, it found that in over 600 contracts, disclosure had not been properly made. Further, false or misleading representations had been made regarding the lender's right to enforce the loan contracts. In 27 incidents, the lender sold the security items and in some cases the lender also published photographs of borrowers in default in local Tongan newspapers. These loans were also not enforceable because disclosure had not been made.

In this case the lender pleaded guilty to 18 breaches of the CCCFA and two breaches of the Fair Trading Act and was ordered by the court to pay $12,520 in statutory damages to affected borrowers.

This case highlights that, in its investigations, the Commerce Commission does not only consider the CCCFA but also the Fair Trading Act when monitoring compliance.

Along with achieving several successful prosecutions, the Commission has entered into settlements with credit providers over disclosure related breaches. At such times, the lender has been required to inform affected borrowers of their right to seek statutory damages and to provide details of borrowers seeking damages to the Commission.

The Commerce Commission has also warned many lenders operating predominately in Pacific Island communities for allegedly failing to provide disclosure. The Commission continues to work with lenders in this sector to promote compliance with the CCCFA.

Credit related insurance

From an enforcement perspective the Commerce Commission has identified a particular area it considers the CCCFA is unclear in relation to disclosure.

Section 70(1) of the CCCFA requires that if a credit contract involves credit related insurance and that insurance was arranged by the creditor, then the person insured must be supplied with a copy of the terms of the insurance within 15 working days of the insurance being arranged. The Commerce Commission notes that the Act does not specify what constitutes disclosure for credit related insurance. The Commission considers that disclosure requirements of the nature of those in sections 32 to 35 of the CCCFA, which set out a detailed methodology for assessing the adequacy of disclosure, should apply to insurance.

There is no policy reason why insurance disclosure under the CCCFA should not be held to the same standard as the other disclosure requirements of the CCCFA.

The easiest option is to specify in the CCCFA that insurance disclosure must be in accordance with the general disclosure requirements of sections 32, 33 and 35. One area where the general disclosure requirements are not relevant to insurance is section 34 relating to the use of a model disclosure statement. Insurance disclosure is not necessarily suited to a model statement format and does not need to be presented as such. The requirements of section 32 should be sufficient to provide lenders and their agents with enough guidance on the Act's expectations regarding how disclosure must be expressed clearly and concisely, and cannot be misleading to any particular that is material to the credit contract.

Proposal Accordingly, it is proposed that insurance disclosure required under section 70(1) must be in accordance with the general disclosure requirements of sections 32, 33 and 35 of the CCCFA.
Q.2 • Is it reasonable to require insurance disclosure in accordance with sections 32, 33 and 35 of the CCCFA?

Additional disclosure suggestions

Improved disclosure on prepayment fees

The CCCFA allows the borrower to repay their credit contract earlier than the terms of the contract originally set out. This is called full prepayment.

If it is specifically included in the credit contract (section 51(1)), the lender can charge the borrower:

- administrative costs relating to the early repayment, for example, the cost of preparing the paperwork and calculations; and
- a reasonable estimate of the creditor's loss from the borrower repaying early.

The Act requires disclosure[3] to be made regarding full prepayment, stating "how the reasonable estimate of the creditor's loss on full prepayment is calculated and whether a statutory procedure prescribed in regulations is used".

These costs must be reasonable, as for all fees in the contract, and are commonly known as break fees. The Credit Contracts and Consumer Finance Regulations 2004 prescribe a "safe harbour" formula to provide certainty to lenders as they generate their prepayment fee. If the fee has been worked out using the safe harbour formula, the fee is deemed to be reasonable under the CCCFA. If an alternative formula is used to determine a prepayment fee, it must meet the reasonable tests of the CCCFA.

Media coverage this year has focussed on borrowers being surprised at the high nature of some prepayment fees being charged when they are seeking to end a mortgage or to refinance at a lower rate to take advantage of a change in interest rates. People have taken exception to prepayment fees being for considerable amounts of money. Media reports have highlighted that the prepayment fees charged by mainstream lenders for the same consumer borrowing scenario have varied considerably. A large number of complaints have been made to the Banking

[3] Section 17 and Schedule 1(p) of the CCCFA.

Ombudsman on break fees. This suggests that borrowers may enter into credit contracts without being fully aware of the potential cost of a prepayment fee. The different approaches that banks use in determining break fees also has been highlighted – some base break fees on retail rates of interest and some on wholesale rates of interest.

One suggestion outlined in a Private Members Bill (Aaron Gilmore, MP, The Credit Contracts and Consumer Finance (Break Fees Disclosure) Amendment Bill) is that there needs to be enhanced disclosure concerning prepayment fees, including:

- requiring disclosure of a schedule of prepayment fees calculated over a range of possible interest rates over various points in a credit contract;
- preventing the prepayment formula from being amended once a credit contract is made; and
- providing a plain English example of how the prepayment fees are calculated as part of the contract.

This suggestion aims to ensure a consumer is informed as to the potential cost of a prepayment fee and also to prevent the possible amendment of the prepayment formula (if permitted by the credit contract) to prevent any further cost to the borrower. By disclosing information to borrowers of the actual prepayment fee in this way, the intent is that consumers will be more informed and make their borrowing decisions accordingly.

Discussion

The CCCFA requires the credit contract must specifically state that the creditor can charge the borrower administrative costs relating to early repayment, for example, the cost of preparing the paperwork and calculations, and a reasonable estimate of the creditor loss from early repayment.

Break fee formulas are complicated. The Credit Contracts and Consumer Finance Regulations 2004 set out one approach that may be used. The purpose of these regulations is to provide certainty to financial providers who choose to use this formula that it will be acceptable as complying with the CCCFA prepayment fees reasonableness test.

In considering the merits of including information about the calculation of any break fee in a credit contract, the objectives of the CCCFA disclosure provisions need to be taken into consideration. The main objective of the disclosure provisions, as noted, is to allow consumers to make informed decisions. Information needs to be clear and understandable to achieve this objective. A second objective is to provide information to the consumer at a later date when the consumer may need to look at the contract because of a possible redress issue or when wanting to amend the contract, for example, for prepayment purposes. Again, the disclosure information must be clear and understandable to achieve this objective.

Requiring the disclosure of a schedule of potential prepayment fees as suggested in the Gilmore Private Members Bill would provide clear information to the consumer as to the possible range of fees that may be charged. Essentially, the Gilmore Private Members Bill envisages that a "matrix" of prepayment fees covering different interest rate possibilities against a time scale would be made available and this could assist the borrower in deciding whether to enter into the credit contract. The matrix gives an indicative alert signal. This option could be enhanced by also requiring lenders to have available on their website and accessible to customers at their business premises detailed, clear information on the calculation they will use for prepayment fees.

A second option is to require the disclosure of a schedule of prepayment fees and an explanation supporting the schedule. One difficulty would be that such information would likely be quite substantial in length. Examples obtained by the Ministry of Consumer Affairs from several banks showed their explanations of prepayment fees ran to over three pages. While this information is clear and concise, its length may contribute to disclosure overload and overshadow the messages of other required disclosure.

The Gilmore Private Members Bill also promotes the prevention of a prepayment formula from being amended once a credit contract is made. The Ministry of Consumer Affairs is currently progressing a comprehensive review of its existing consumer law known as the "One Law" review. This work includes an examination of the Fair Trading Act 1986 and whether it should include some form of protection from unfair contract terms. A credit contract that allows for a variation of the prepayment formula and which is subsequently applied in a way that could be considered unfair in that it causes detriment to the consumer, may be found to be an unfair contract term. International legislation provides that when an unfair term is identified by the Court then the contract can be varied to remove or set aside the term.

Proposal

Consideration should be given to providing more information in credit contracts on making prepayments including that prepayment could incur significant costs.

Q.3

- What are your views on increasing the disclosure required for prepayment fees? Is your preference for an "alert", for example, a matrix of possible scenarios, or detailed estimates?
- Will disclosing full information on potential break fees across various timelines and a range of differing interest rates provide a more useful basis than an "alert" on which to inform the lending decision?
- Will provision of such information run the risk of crowding out other relevant disclosure information?

Commerce Commission v Avanti Finance Limited – a Case regarding Prepayment Fees[4]

Commerce Commission v Avanti Finance Limited is a notable case under the CCCFA.

Avanti Finance Limited (Avanti) is a finance company providing consumer credit to the public. The loans range from $1,000 to $30,000, and are regulated by the CCCFA and the 2004 Regulations made under that Act. If a debtor chooses to prepay their credit contract early, Avanti charges a "prepayment fee", which is calculated according to a formula which is stated in each credit contract.

The Commerce Commission brought this case against Avanti (in the District Court), alleging that the prepayment formula used in their contracts did not calculate a reasonable estimate of their loss, and therefore did not comply with the CCCFA. Avanti maintained the formula they used did in fact represent a reasonable estimate of their loss.

The CCCFA has provisions relating to early prepayment, specifically ss 50 and 51, which refer to the debtor's right to full prepayment, and the amount required for full prepayment, respectively. The Regulations prescribe the "safe harbour formula", which calculates the prepayment fee. As it is provided for in the Regulations, if used by credit companies, it is automatically deemed a "reasonable" estimate of the creditor's loss (under s 54 of the CCCFA).

The Commerce Commission's prosecutions were based on 50 credit contracts terminated utilising s 50 of the CCCFA, between June 2005 and December 2006. The charges were brought under ss 51 and 54 of the CCCFA, and were the first prosecutions brought under these sections which went to a hearing. The Commerce Commission contended that Avanti's formula did not meet the requirements of the CCCFA.

The outcome of the trial was the judge found for Avanti. It was held the safe harbour formula did not accurately reflect Avanti's loss from prepayment, and so the judge was satisfied the formula Avanti used for the prepayment provision in their credit contracts was a reasonable estimate of their loss. The Commerce Commission appealed the decision stating that the appeal would seek clarity on the principles of law relating to consumer credit law.

In the appeal, the Commerce Commission argued that sections 51 and 54 of the CCCFA required Avanti to calculate its estimate of loss on the assumption that it would immediately re-lend the funds prepaid at the then prevailing interest rates. They relied on the safe harbour formula (outlined in s 54(1)(a)) as a general indication of what is reasonable.

The judge interpreted the phrase "reasonable estimate of loss" as meaning an estimate that on an objective informed analysis, at the time of entering into the credit contract, would do no more than compensate the creditor for the actual losses it could expect to sustain in the event of prepayment.

The judge agreed that the District Court Judge was correct to describe the Avanti formula as conservative and one which produced a fee less than its estimate of loss.

The Court therefore found that Avanti was not required, for the purposes of ss 51 and 54 of the CCCFA, to calculate a reasonable estimate of its loss on the assumption that it would immediately re-lend the funds prepaid at the then prevailing interest rates, even when it had excess lending capacity.

The appeal was therefore dismissed.

[4] DC AK CRI -2007-004-010204 [10 June 2008]; HC AK CRI-2008-404-210 [28 April 2009]

Improved disclosure for minimum credit card repayments

Credit cards are a widely used form of credit. For the year ended July 2009, credit, debit and charge card use accounted for 45% of transactions. Transactions do not include those with overseas merchants.

Reserve Bank figures indicate that as at year ended June 2009 New Zealanders had $5 billion owing on credit cards.

Interest on credit cards is the principal means by which card issuers make their money. Reserve Bank figures indicate that 70 percent of credit card balances ($3.5 billion) are outstanding debt which is attracting interest charges.

One common feature on credit cards is the ability to pay what is known as the "minimum amount". This payment is significantly less than the full cost of the outstanding monthly balance on the credit card (2 to 5 percent of the outstanding balance is typical). If the minimum is paid, or any less than the full amount owed, interest accrues on the unpaid balance and sometimes fees are charged. As well, when there is a balance outstanding on the credit card, interest may be charged on any additional purchases added to the credit card balance.

If a borrower only ever paid the minimum balance due, they would take many years to pay off the credit card debt. For example, if a credit card that attracts an annual interest rate of 19% is used for a purchase of $2,500 in goods – say a high definition television - paying only the minimum interest repayment of 3 percent of the outstanding balance per month would mean that it would take approximately 13 years to repay the cost of the television and associated interest charges.

Consumer NZ raised for discussion, in its August 2009 Consumer magazine, that many credit card users may not understand the significance of paying only the minimum or are influenced to pay only the minimum by behavioural factors. Consumer NZ cites research that found giving minimum-payment amounts on credit card statements can lull consumers into paying less than they otherwise would.

Dr Neil Stewart, Psychology Researcher, University of Warwick, UK, argues that minimum repayments can act as "psychological anchors". When the credit card statement highlights this repayment level, the borrower may fall into the trap of feeling they have been "assigned" that amount and that is the amount they pay.

One means to inform people about the effect of only paying minimum repayments is to require that credit card issuers provide disclosure regarding the true cost of interest that accrues when minimum payments are made. This could be done at the time each monthly statement is presented to the borrower. For example, it could include a reference to the interest that will generate on the account that month if only the minimum payment is made. The intention would be that by drawing the consumer's attention to the effects of minimum repayments, the consumer could make a more informed decision about the timing of repayment of the credit card balance.

The United States recently passed legislation that will come into effect in 2010 requiring: credit and charge card application and solicitation disclosures to be more meaningful and easier for consumers to use; and disclosure of the effect of only making the minimum payments on the time-to-repay balances.

Q.4

- Should credit card issuers be required to provide disclosure regarding the true cost of interest that accrues when minimum payments are made?

Disclosure and pawnbroking

The CCCFA and the Secondhand Dealers and Pawnbrokers Act (SDPA) both commenced on 1 April 2005. These two statutes were intended to sit side by side and work in a complementary manner.

The SDPA focuses on discouraging crime related to stolen goods and the CCCFA focuses on protecting consumers entering into credit contracts. The link between the two Acts is created through the definition of consumer credit contracts which include pawnbroking contracts. Pawnbroking transactions involve the deferred payment of a debt and must comply with the requirements of both the SDPA and the CCCFA.

The New Zealand Licensed Traders Association (NZLTA) has raised concern about the relationship between the two Acts, in particular compliance difficulties for pawnbrokers in meeting the requirements of both Acts. Particular areas of concern noted are the calculation of interest, disclosure requirements and early repayments.

Pawnbroking – a brief outline

Pawnbroking is a long-established form of lending, the principles of which are well known and understood. The requirements of the SDPA reflect this longstanding practice.

Licensing

The SDPA requires that a person providing pawnbroking services must hold a licence or certificate. Licences are issued by the Ministry of Justice and involve a vetting process that includes a "fit and proper person test" undertaken by the Police. The licence is issued for a nominated premise or premises where the pawnbroking transactions must occur. Other persons may also operate as pawnbroking agents from these premises and they must hold a pawnbroking certificate. Certificates involve the same vetting process as for licences, but are not defined to particular premises.

The public register for pawnbrokers, managed by the Secondhand Dealers & Pawnbrokers Licensing Authority (part of the Ministry of Justice), indicates that there are approximately 2,800 current pawnbroking licences and a further 1,600 certificate holders. Some of the licences listed on the register have more than one address nominated. The registration of pawnbrokers is intended to control the "suitability" of persons operating in the pawnbroking industry. When a pawnbroker has breached the conditions of their licence, the Police may seek to have the pawnbroker's licence or certificate revoked or suspended.

Loan transactions

When a consumer enters into a pawnbroking loan arrangement they sign a pledge certificate under which they assign possession of the item being pawned, for a specified period of time, to the pawnbroker in exchange for a cash advance. The pledge certificate sets out the details of the arrangement including the date redemption must occur by and the amount the consumer has to repay to redeem their goods[5]. The amount owing on redemption is the amount advanced plus the interest charged.

To redeem their goods, the consumer must pay the redemption amount stated on the pledge within a specified period.

A difference between pawnbroking and other credit contracts is that the pawnbroker is required to physically hold the security for the loan (the item pawned).

If the consumer fails to pay the redemption price of the pledge by the set date, the pawnbroker is entitled to sell the security (the item pawned) to recover the redemption price. If the redemption price cannot be met by the sale of the goods then the pawnbroker accepts this is as a loss and no further amount is owed by the consumer. Where the sale value exceeds the redemption price the pawnbroker must attempt to contact and return, at a minimum, 90 percent of the sale price above the redemption value.

Pawnbroking loans are credit contracts
As a credit contract, a pawnbroking loan arrangement also must meet the requirements of the CCCFA.

How pawnbroking disclosure is working in practice

As noted, pawnbrokers have raised concerns about different approaches to disclosure, interest and early loan repayments under the CCCFA and SDPA. The different approaches and resultant issues are discussed below.

Interest, fees and charges
Comparing the treatment of interest between the SDPA and CCCFA two distinct differences are apparent: the cost elements that may be included as interest; and the way in which interest is applied and accrues on a loan. These two factors become most apparent in the disclosure requirements established under each Act.

Calculation of interest, fees and charges
Under the SDPA, interest is the only mechanism for a pawnbroker to recover the costs associated with the transaction including any business profit. The SDPA states that a "pawnbroker may charge only interest, and not any other fee or charge (however described), as part of the redemption price of pawned goods" (section 57(2)). The interest on the loan is added to the amount advanced to calculate the redemption price payable on or before the redemption date of the pledge.

The SDPA does not define interest and is silent on the elements that may or may not be incorporated into the interest applied to a pawnbroking loan. Practice suggests that under the SDPA the interest charged covers the business costs for storage, establishment and administration of the pawn transaction and a profit margin. In effect, the interest payment is a lump sum payable upon redemption.

In comparison, the CCCFA makes a clear distinction between the application of fees and charges and interest that may be applied to a loan. This distinction comes out in both the treatment of interest and the definition of "credit fees". Under the CCCFA, interest is treated as a charge that accrues over time determined by applying a rate to the amount owing on the loan.

---

[5] In order to reduce trade in stolen goods, pawnbrokers also are required to collect and retain certain details about the items being pawned and the person pawning them. These records must be kept for a certain period and be accessible to the Police.

The definition of credit fees is:

fees or charges payable by the debtor under a credit contract, or payable by the debtor to, or for the benefit of, the creditor in connection with a credit contract (including any insurance premiums payable if the creditor requires the debtor to obtain insurance cover from a particular insurer); but not including the following:

- *interest charges:*
- *a charge for an optional service:*
- *a default fee or a default interest charge:*
- *government charges, duties, taxes, or levies.*

The CCCFA disclosure requirements for consumer credit contracts are set out in Schedule 1. Whilst Schedule 1 says that each credit contract needs to disclose just the applicable key information, it requires interest and credit fees to be presented on the disclosure documentation separately and the disclosure of an annual interest rate.

These requirements do not sit comfortably with the SDPA's requirements for pawnbroking transactions which are to present one value - the total cost associated with the loan.

Pawnbrokers argue that in trying to comply with the CCCFA's disclosure requirements for interest and credit fees, they must present additional calculations and data to the consumer. The problem is that this additional disclosure does not necessarily provide the consumer with any benefit in terms of understanding the transaction or the ability to determine whether the arrangement is in their best interest. It may even be confusing.

Examples have been identified of pawnbroker's attempts to apply the CCCFA to pawnbroking transactions and meet the disclosure requirements of both Acts in one document. These attempts have resulted in contracts that are confusing not only to the consumer but also to those providing legal advice on the contract. The contracts presented to the consumer would not appear to satisfy either the SDPA or the CCCFA disclosure requirements.

Prepayment

As noted, the SDPA provides for a single payment for redemption of a pawned good. The single payment applies whether the good is redeemed earlier or by the final date specified for redemption. A non-mandatory, early payment discount may be provided. If offered, this must be recorded on the pawnbrokers record and the pledge certificate which under sections 51(2)(h) and 59(2)(c) require that "the total redemption price payable at the redemption date, and whether any lesser amount is payable if the goods are redeemed before that date" must be set out.

In comparison, the CCCFA provides for prepayment of a loan based on the premise that interest accrues over time and that if the loan is repaid early the interest ceases to accrue. As noted, this approach sits alongside a regime where credit fees are treated separately from interest and are added on to the initial balance of the loan. There may also be a fee for early loan repayments. Given the CCCFA applies to pawnbroking loans, a problem arises from the different approach to early payment in the SDPA. Under the SDPA, all costs associated with the pawnbroking transaction are included in the lump sum interest charge so applying the CCCFA prepayment requirements would affect the pawnbrokers recovery of costs associated with the transaction.

As with the different treatment of interest and fees, the different approach to early payment under the SDPA and CCCFA is confusing and is a compliance cost for both pawnbrokers and consumers. The uncertainty also does not allow for easy enforcement.

Disclosure
The issues of different interest treatment and prepayment provisions in the two Acts is causing compliance problems for pawnbrokers trying to meet the disclosure requirements of both Acts, due to uncertainty and lack of clarity about their disclosure obligations. Both the SDPA and CCCFA have requirements for the disclosure of details relating to the transaction but how to treat the differences in these requirements is unclear.

The disclosure requirements for the two Acts are set out in the following table.

Table 1: Disclosure requirements of the CCCFA and SDPA

Secondhand Dealers and Pawnbrokers Act (sections 59 and 51(2)(b)-(h))	**Credit Contracts and Consumer Finance Act (Schedule 1)**
Name of pledger	Not required under CCCFA
Address where pawned good can be redeemed	Name and address of creditor
Description of the pawned item	Not matched in CCCFA – description of any security interest taken in connection with the contract (taking of security optional)
Number assigned to item by pawnbroker	Not required under CCCFA
Name and signature of the pawnbroker	Full name and address of creditor
Redemption date	Payments required
Amount of money advanced on the goods	Initial unpaid balance
Interest to be charged	Not matched in CCCFA – may equate to total interest charged + credit fees and charges (applied on establishment)
Total redemption price at redemption date and; whether any lesser amount is payable if goods redeemed before that date.	Not matched in CCCFA – may equate to total advance + total interest + credit fees and charges and possible full prepayment provisions
A summary of the rights of pledgers and obligations of the pawnbroker under the pledge as provided in the SDPA.	Not matched in CCCFA – statement of right to cancel, including how to cancel + time limits for cancellation + what you have to pay if you cancel.
Not required under SDPA	Credit limit
Not required under SDPA	Method of charging interest
Not required under SDPA	Annual interest rate
Not required under SDPA	Schedule of fees and charges
Not required under SDPA	Schedule of default interest charges and default fees
Not required under SDPA	Interest free period
Not required under SDPA	Continuing disclosure

While parallels can be drawn between the disclosure requirements in each Act, the actual legal requirements mean that disclosure under one Act will not meet the requirements of the other, for example, the statement of right to cancel under the CCCFA.

As noted, pawnbrokers are concerned that to meet their legal obligations, two disclosure statements, one under each Act, must be made. While it is possible for pawnbrokers to meet the "double" disclosure requirements, it introduces additional compliance costs. Presenting similar information in two different formats also has the potential to confuse consumers.

In reality, however, confusion is avoided because it seems that pawnbrokers are meeting the requirements of the SDPA rather than the CCCFA and not providing both forms of disclosure to consumers. The Commerce Commission has indicated that pawnbrokers not meeting the CCCFA disclosure requirements is an area they have identified in terms of compliance. They have issued several letters reminding or warning pawnbrokers of their disclosure requirements under the CCCFA. The Commerce Commission had a recent settlement with a pawnbroker in relation to a failure to meet the CCCFA's interest calculation and disclosure requirements.

Options for addressing the above problems

The issues identified above suggest that there is a need to revisit the interface between the two Acts. One solution is to remove pawnbroking transactions from the CCCFA altogether. While this option would resolve the issues identified it would also remove an entire line of credit from the provisions of the CCCFA that protect the interests of consumers entering into credit contracts.

This is not favoured. The SDPA is not consumer protection legislation. Although there is no evidence that pawnbroking credit provision is causing consumer concerns or detriment, this type of credit provision is used by those who often are at higher risk or likelihood of using fringe providers. The Police are responsible for monitoring and enforcement under the SDPA, but this enforcement is to ensure no connection between pawnbroking and stolen goods and crime exists. It is not an appropriate role for the Police to check the correct application of the credit provisions. Rather, this role sits appropriately with the Commerce Commission as part of their monitoring and enforcement role.

The preferred option is to provide in the CCCFA that the SDPA disclosure requirements meet the appropriate CCCFA disclosure requirements.

This option would maintain the SDPA requirements for information that must be disclosed on the pledge certificate. These are specifically suited to the pawnbroking transaction, providing detail on the loan's duration, the amount required to redeem the pawned item, a description of the item and details of the lender and borrower. For the type of loan, the disclosure required under the SDPA appears to enable the consumer to assess the arrangement adequately. This is a form of credit arrangement that has a long history.

This option would mean the Commerce Commission would continue to have a monitoring and enforcement role in relation to pawnbroking credit transactions.

A variation on option two would be to consider amending the SDPA to require the specific separation of interest and fees and other charges. Whilst this would make the pawnbroking disclosure more in line with the interest and fees separate disclosure approach in the CCCFA, it is questionable whether it would provide any advantages to consumers and it would mean additional compliance costs for pawnbrokers. As noted, the pawnbroker's pledge provides very clear information to the consumer. Accordingly, this variation is not recommended.

Prepayment and continuing disclosure
In addition to providing for the SDPA disclosure requirements to satisfy the CCCFA disclosure requirements, it is proposed that pawnbroking be exempted from the CCCFA prepayment and continuing disclosure provisions.

As noted, the SDPA includes an optional form of prepayment. The CCCFA prepayment provisions also do not sit well with pawnbroking as a form of credit.

Typically ongoing disclosure is not required under pawnbroking transactions as the duration is less than 6 months. The CCCFA's continuing disclosure requirements are also not particularly relevant to pawnbroking as the terms of the loan arrangement generally do not change over the redemption period.

The right to request disclosure under the CCCFA can be met, in essence, by the SDPA's requirement to issue a replacement pledge certificate upon request. For this the lender must produce adequate identification that will be checked against the pawnbroker's records to ensure they align.

Proposal

Accordingly, it is proposed that for pawnbroking credit contracts that come within the SDPA -

- the requirements of section 17 and Schedule 1 of the CCCFA are met by compliance with section 59 of the SDPA; and
- there is an exemption from sections 18, 19, 20 and 21 (continuing disclosure) and sections 43, 48, 49, 50, 51 and 54 (prepayment).

Q.5

- Do you agree that the above option would reduce problems associated with the clashes between the SDPA and CCCFA for pawnbroking credit transactions?
- What advantages or disadvantages do you see this option provides to consumers and traders?
- Are there other options to address the issue?

4. Credit Fees and Charges

Background

As noted in the discussion on information disclosure, the CCCFA has considerable emphasis on disclosure of information to consumers. This includes that consumers should be able to clearly distinguish between the interest applying to a credit transaction and the fees and charges that will or may be made.

The CCCFA sets out provisions on the fees that may be charged in relation to a consumer credit contract. The fees allowable are broken into credit fees, default fees and fees and charges for optional services.

Credit fees are defined as fees or charges payable by the debtor under the contract or payable for the benefit of the credit provider. Credit fees cannot include interest charges, charges for optional services, default fees/interest or any government charges, duties, taxes or levies.

Credit fees include a wide range of fees. Some are specifically defined in the CCCFA, such as establishment fees. Other credit fees include letter fees, variation fees, prepayment fees, pre-possession notice fees, post-possession notice fees, storage costs and administration fees.

Establishment fees are a form of credit fee and cover costs associated with establishment of the loan, for example, fees for making an application and its processing and documentation. Fees or charges for optional services cannot be included as establishment fees.

Default fees are fees or charges that may be payable by the debtor upon breach but do not include default interest charges.

Fees and charges for optional services, such as insurance or extended warranties, are treated separately. Section 45 requires that the amount charged to the loan must be the actual amount paid by the credit provider, for example, the cost of the service less any discounting that the credit provider obtains. The credit provider is able to add a commission charge for arranging the optional service, however, the commission charged to the debtor must be reasonable.

Sections 41 to 44 of the CCCFA effectively say that a consumer credit contract must not include a credit fee or a default fee that is unreasonable. The reasonableness of fees or default fees may be challenged through the Court and if the Court considers that a fee is unreasonable it may order that the fee be annulled or reduced.

Where establishment fees have been charged and questioned, a Court must have regard to whether the amount of the fee is equal to or less than the creditor's reasonable costs in relation to the application for credit.

Prepayment fees may be applied by a credit provider where the borrower chooses to pay off all or part of the loan as a lump sum. If prepayment fees are included under the contract, section 54 of the CCCFA allows the credit provider to calculate a reasonable estimate of its loss from full prepayment using "an appropriate procedure set out in the consumer credit contract for calculating that loss" or by using "a procedure prescribed for the purposes of this section by regulations". A procedure known as the "safe harbour" formula is provided in the Credit Contract and Consumer Finance Regulations 2004 made under the CCCFA.

When considering the reasonableness of prepayment fees, the Court must consider how the formulae have been applied in relation to the actual losses that may have been generated through the prepayment. If the fees are considered unreasonable they may be reduced or annulled.

Discussion of how the fees provisions are working in practice

What is an unreasonable fee?

The separate identification of fees from interest would appear to have increased some consumer awareness of fees. This is evidenced by media commentary on "bank" fees, most recently break fees (see discussion of Improved Disclosure of Prepayment Fees, p. 19) and recent announcements by some banks to changes to their dishonour fees following consumer feedback.

The Commerce Commission has noted a significant amount of variability in the practices associated with the setting and justification of fees. Fees may be set to recover costs and also to collect revenue.

Essentially the fees provisions of the CCCFA are principle-based – the principle being that they cannot be unreasonable. Both the Commerce Commission and community agencies, however, have commented that the principle-based approach to the fees provisions does leave some uncertainty and lack of clarity for consumers and businesses about what may be included in fees and the recovery of costs.

In response to this interpretation problem, the Commerce Commission has released draft guidelines which have the objective to inform creditors and consumers about the Commission's approach to enforcing the fees provisions under the CCCFA. The Commission has received submissions on the draft guidelines and is currently considering these before finalising the guidelines.

In the absence of judicial precedent, the Commission considers this guidance should provide further clarity and enable the credit industry to set fees that are consistent with the approach taken by the Commission. By signalling the approach the Commission will take when considering investigations, this may help lenders to avoid enforcement action.

The Ministry of Consumer Affairs welcomes the Commission's initiative to provide guidelines. They will help reduce uncertainty for some lenders and generally educate the industry as a whole. Coupled with existing enforcement strategies, the Ministry believes this approach will improve the operation of the CCCFA.

The alternative approach to guidelines would be to incorporate into the CCCFA or in regulations under the CCCFA more prescription on what can be included in fees.

Q.6

- Do you think the provision of fee guidelines will provide sufficient advice for industry to develop their fee structures?
- Does there need to be more regulation or prescriptive guidelines for fees; if yes, in what areas?

Frontloading of fees for services

Frontloading of fees involves the upfront charging for a service that would otherwise accrue over the period of the loan. In other words, the cost of the service instead of being spread across the loan period is charged in full at the loan's commencement. The Commerce Commission has noted several instances of this occurring. It is concerned that the practice results in the borrower paying more over time, because the frontloaded fee is added to the initial loan and thus interest accrues on a large initial amount borrowed.

An example of a frontloaded service is that of a vehicle immobilisation device. The device is commonly installed into motor vehicles at the borrower's expense. Each month or payment period a code is provided to the lender. The lender then provides this code to the debtor upon payment. The code can then be entered into the vehicle's management system which allows the vehicle to operate until the next code is required. If a payment is not made, the code can be withheld and the vehicle is rendered inoperable. This incentive is that to use the car, the borrower must make the due payment. When this is made, a new code is offered.

In addition to the initial installation costs, there is a fee for the ongoing maintenance cost of supplying the immobilisation service. Frontloading occurs when the ongoing maintenance cost is charged at the loan's inception rather than accruing over time, for example, if a loan is for 3 years, 36 monthly fees are frontloaded at the start of the loan and immediately accrue interest, despite the service not having been performed.

The concern is that these types of costs should only be recovered at or around the time they fall due.

Proposal

Consideration should be given to amending the CCCFA to clarify that fees for services should only be charged when the service has been performed or is due to be performed; and that where a loan has been repaid early and a service has been paid for but not performed, the fee should be refunded to the consumer.

Q.7

- Should the CCCFA prevent fees for future services from being frontloaded into the start of the credit contract?

Timing of reasonableness applications to the Court

Section 41 of the CCCFA allows for the Court to order that when a credit or default fee is unreasonable the fee may be annulled or reduced. An application for a reasonableness order must be within one year of the day that the fee is imposed or debited under the consumer credit contract (section 41(4)).

It is most likely that applications to the Court for an annulment or reduction of a fee will be taken by the Commerce Commission. The Commission has noted that it may not necessarily receive a complaint from a consumer or discover the issue itself until well after the alleged infringement has taken place. The effect of this is that the window for the Commission to complete an investigation, take a prosecution and present it to the Court is very short.

The time restriction for taking a case to Court would appear to be unnecessarily restricting investigations, enforcement and the seeking of redress for genuine cases.

Proposal Consideration should be given to either defining a longer period for an application to the Court under section 41 of the CCCFA to annul or reduce a fee, or not providing any time limit for applications, meaning that the time limits of the Limitation Act 1950 would apply.
Q. 8 • Is there a need to change the timeframe under section 41 of the CCCFA for applications to annul or reduce a fee?

Passing on of third party fees

On several occasions when the Commerce Commission has been assessing the fees charged by a lender, it has questioned whether brokerage fees passed on were for genuine, independent brokering services. This situation seems to occur particularly with motor vehicle traders and an associated motor vehicle financier.

The intention of the CCCFA is to allow third party fees or charges to be passed on by the creditor at cost. The concern is that if these fees or charges are not from a genuine, independent party they are being used as a way of avoiding the unreasonable credit fees test.

One way to address this issue is to require that any fees or charges may only be passed on by a creditor if the fees or charges are from a third party at an arm's length relationship to the creditor. An arm's length relationship is when a person is not, or having been, ceases to be, under the influence or control of another.

Any other fees or charges would still be allowable as credit fees but would be subject to the CCCFA's test that fees are not unreasonable. This approach continues to allow genuine brokerage fees and charges to be passed on.

Proposal That fees or charges may only be passed on by a creditor if the fee or charge is from a third party at an arm's length relationship to the creditor.
Q.9 • Should the CCCFA be amended to provide that fees or charges may only be passed on by a creditor if from an arm's length third party?

5. Hardship Provisions

Background

Under the CCCFA's hardship provisions, a consumer can seek relief or relaxation of a credit contract's terms if unforeseen hardship is experienced as a result of a change in personal circumstances. This is provided the consumer is up to date with the credit repayments. The Act allows the consumer to make a request to their credit provider for a reasonable variation to the terms of the credit contract to enable continued servicing of the contract.

Requests for credit contract variations are made by consumers under the hardship provisions and are assessed and approved at the discretion of the credit provider.

The intention of these provisions is to provide a means to help borrowers whose circumstances have unexpectedly changed so that they may continue to service their loan, without financially disadvantaging the lender. The provisions do not reduce the consumers' overall debt obligation.

What is unforeseen hardship?
Section 55 of the Act sets out that unforeseen hardship is illness or injury, losing one's job, the end of a relationship or other reasonable cause. Consumers can only apply for relief or relaxation of the terms of the contract if they could not have foreseen the hardship when they entered the contract, for example, they had an accident six months after taking out the loan and because of the accident had to stop working. A debtor in such a situation may apply for changes to the credit contract.

What variations to the credit contract can the debtor apply for?
The variations that debtors can apply for under a CCCFA hardship application are:

- extending the contract term and reducing the amount of each payment due under the contract;
- postponing, during a specified period, the dates on which payments are due (which may or may not extend the contract term); and
- extending the contract term and postponing during a specified period the dates on which payments are due under the contract.

The specific hardship variations are to give debtors relief so they can meet their contract obligations in the long term. The debtor needs to be able to meet the new arrangements.

While debtors may request other amendments to the contract, such as reductions in annual interest rates or the unpaid balance, these elements do not need to be considered by the creditor in assessing the application. This said, the debtor's statutory right to apply for a hardship variation does not limit any changes that may be made by agreement between the creditor and the debtor. Creditors may go over and above the provisions of the Act to find solutions to avoid default (provided they are in the borrower's interest).

When is the borrower unable to apply?
The debtor must show that they have suffered unforeseen hardship. A debtor cannot apply if:

- they are currently in default on a payment (in other words, the payments must be up to date);
- a credit limit has been exceeded;

- the hardship was reasonably foreseeable at the time of entering into the contract – e.g. if a debtor sustained an injury before entering the contract knowing they may not be able to continue their job and maintain their repayments.

If the credit provider declines to vary the terms of a credit contract, the consumer can apply to the Disputes Tribunal or Court to have the contract varied. The ability to have the courts rule on particular cases provides a safety valve for both consumers for unduly rejected applications (and lenders for frivolous applications).

How the hardship provisions are working in practice

When should hardship applications be able to be made?

As noted, the borrower may only apply to use the hardship provisions if payment obligations are up to date. This means that when a borrower is in a situation of unforeseen hardship the borrower promptly needs to make an application to the lender so arrangements (variation to the credit contract) can be made.

Community organisations have indicated that for many debtors seeking their help, the problem is that although there has been a change in personal circumstances, assistance is not sought before their loan is in default. This may be occurring because the person is under stress due to an unforeseen change in personal circumstances, such as a marriage breakdown, death of a spouse, serious illness of a child or severe personal injury and has not given consideration to the loan repayments and has fallen behind in the repayments.

In light of their experience, community organisations would prefer the CCCFA to be extended in scope to allow for hardship applications when a borrower is in default.

It is difficult to quantify the extent of unforeseen circumstances that lead to hardship in repaying debt. There is no formal monitoring programme in place; however, there is strong anecdotal evidence.

Feedback sought from two Auckland based Citizens Advice Bureaux (CABx) has revealed that, per quarter, many hundreds of people seek advice on debt issues who would benefit from access to the hardship provisions. The CABx advise that their clients are more likely to come to them for assistance only once legal proceedings have been initiated against the debt. In the majority, these debts are more than one month in default (and it is unrealistic that the borrower will be able to get the account up to date). As such, the borrower is not entitled to apply for hardship relief. In this situation relief may be granted at the grace of the lender and the CABx try very hard to achieve this outcome by negotiating directly with the lender on the borrower's behalf.

Extending the hardship provisions

The benefit of extending the scope of the hardship provisions to those in default is that more people suffering unforeseen hardship would be able to seek relief using the provisions of the CCCFA and avoid financial penalties which further exacerbate their financial problems.

Mainstream banks have indicated they generally take a more helpful stance than simply adhering to the hardship provisions of the Act, often making arrangements with consumers over and above the current statutory provisions. This help is beyond just being willing to consider a hardship application when a person is in default. For example, one bank now operates a service where they proactively monitor customer accounts for patterns that suggest a situation of financial pressure. Personal contact is made when such patterns are identified to discuss suitable arrangements.

Recent publicity regarding mortgages has prompted some banks to announce in the media their willingness to help their customers having difficulty with debt and repayments.

Some credit providers may be hesitant to support the proposal of extending the hardship provisions. Prior to the enactment of the CCCFA, some in the finance sector expressed concern about the hardship provisions extending to those in default.

Extending the hardship provisions would mean a lender could not collect default fees and penalty interest. The lender would not, however, lose out overall on the initial expected return on the loan. When hardship relief is granted, repayment of the loan is still expected and in most cases the loan repayment period will likely be extended with no loss of revenue to the lender.

It is worth noting the Australian view on default and the borrower's ability to negotiate a variation to the terms of the loan is consistent with the above view that consumers should be able to apply for hardship relief when in default. The *Australian Universal Consumer Credit Code* provides that if consumers default on a loan because of illness, unemployment, or other reasonable cause they are able to ask the lender to vary the terms of the contract.

Australian Initiative for Credit Assistance

In April 2009, the Australian Government and the four major Australian banks reached agreement on a common approach for assisting borrowers facing financial hardship. This move was in response to the current credit crunch, and particularly aimed at helping borrowers who may struggle to meet loan repayments if they lose their job.

The common approach places obligations on the four major banks to provide temporary relief to borrowers and to provide assistance options that take into consideration the needs of the borrower concerned.

The CCCFA already provides for this approach through the hardship provisions that allow consumers to apply for such relief. Sections 55 to 59 of the CCCFA provide for changes to the credit contract (including mortgages) on the grounds of unforeseen hardship.

The issue in the New Zealand context is how best to inform consumers and lenders of this tool.

In summary, providing borrowers the opportunity to access the hardship provision when in default gives them the opportunity to get back on track to satisfy their loan commitment. This accords with the intention of the Act and its relief provisions.

Proposal

Accordingly, it is proposed to add to Part 2 subpart 8 of the CCCFA that borrowers may also apply for unforeseen hardship relief when they are in default of a credit contract by no more than two months.

Q.10

- Do you agree that hardship applications should be able to be made when in default? Is the two month timeframe appropriate?

Timeframes for acknowledgement and processing of hardship applications

As discussed, the CCCFA provides that hardship applications can only be made when a borrower is current with their payments. Community organisations have advised that some lenders do not act on applications in a timely manner and in many instances this results in the debtor falling behind in payments. As a result, the debtor is no longer eligible to access the hardship provisions. Community organisations have also suggested that it appears as though some lenders are intentionally trying to frustrate hardship applications by purposefully delaying their assessment. In some cases delays can be for weeks or months, during which default fees and penalties may have accrued on the debt.

Delaying the assessment of hardship applications can place further financial and emotional stress on an already stressed borrower. The concern is that delays in assessing applications, whether deliberate or not, is resulting in consumer detriment that the Act specifically intended to provide limited relief for.

One approach to addressing this problem is to require acknowledgement of hardship applications within 5 working days and to provide that hardship applications are fully considered and processed within 20 working days of receipt of the application.

Requiring acknowledgement of applications would potentially add to the cost of receiving and considering applications, although this should not be a significant cost.

As noted, as a result of hardship applications not being processed in a timely manner, the borrower goes into default and typically must pay financial penalties, which adds to the overall financial stress (hardship) of the consumer.

One approach to addressing this problem is to prevent lenders from applying default fees, penalty fees or interest to the loan during the application assessment period. This would provide an incentive for lenders to assess applications in a timely manner. To prevent abuse of such a provision by consumers, the suggestion is that if an application is declined because the application is not one of unforeseen hardship, default/penalty fees could legitimately be applied as per the credit contract.

The intent of these suggested approaches is to limit unnecessary or additional borrower uncertainty/distress.

To complement these suggested approaches and to promote compliance, it is proposed that if a lender has not made a decision within 20 working days of the receipt of a hardship application and communicated this to the borrower, then the borrower has the automatic right to apply to the Disputes Tribunal or the Court to vary the credit contract as they see fit according to Part 2 subpart 8 of the CCCFA. The ability for the Disputes Tribunal or the Court to make an order as it sees fit, should be an incentive for lenders to expeditiously process applications.

The Ministry considers that these proposals will go some way to allowing the hardship provisions to work as intended.

An additional suggestion is that when a hardship application is declined, the lender should provide the reasons for declining in writing and advise the borrower that he or she may apply to the Disputes Tribunal or the Court to change the terms of the contract. This would provide clear information and assist the borrower in deciding whether to take further action.

Proposal

Accordingly, it is proposed that Part 2 subpart 8 of the CCCFA is amended to provide:

- Lenders be required to acknowledge receipt in writing of a hardship application within 5 working days of the application being made;
- Decisions to grant contract variations under the hardship provisions must be made within 20 working days of receipt of the application;
- Penalty fees and penalty interest cannot be charged during the period of consideration of a hardship application, provided that if the application is turned down then penalty interest and fees can be applied, including for the period of application processing; and
- If a decision has not been made either to accept or decline a hardship application within 20 working days of receipt of the application, the consumer may apply to the Disputes Tribunal or Court to vary the credit contract as it sees fit.

Q.11

- Will these proposals improve the effectiveness of the hardship provisions?
- Are the acknowledgement and processing timeframes proposed realistic and appropriate?
- Do you think failure of a lender to meet their obligations should result in the Disputes Tribunal or Court being able to vary the credit contract?
- By what means should an application for hardship be recognised? Should it have to be in a written form – letter or email – or should allowance be made for verbal applications?
- Should a lender have to provide the reasons for declining a hardship application?

Charging of a fee for a hardship application

The Ministry of Consumer Affairs, the Commerce Commission and community agencies are aware of several credit contracts that contain clauses specifying charges for considering hardship applications.

It is acknowledged that the CCCFA allows the charging of fees in addition to interest charges to recoup the costs associated with the administration of credit contracts. The policy underpinning the legislation, however, did not anticipate a fee for hardship applications under Part 2 subpart 8 of the Act.

Charging a fee for a hardship application is contrary to the intention of the CCCFA to provide some relief to a borrower from an unforeseen circumstance. Charging a fee is highly likely to add to the financial stresses of the borrower.

One particular contract was found to include a fee for $150 to consider a hardship application and another credit provider was found to have charged a $450 "refinance" fee after considering the hardship application. Of particular concern is the possibility that hardship applications or refinancing fees are being used as a disincentive for making an application. In the examples cited, the fees were added to the borrower's debt.

A mainstream bank has noted that they charge an application fee on a cost recovery basis. While it is arguable that such fees may be considered reasonable under the CCCFA, they go against the intention of the Act to provide relief to borrowers who find themselves in unforeseeable situations of hardship. Their use actually compounds the immediate financial hardship at a time when this is least affordable.

The Commerce Commission has noted several occasions where a borrower in financial difficulty has been extended further credit when applying for hardship. This refinancing attracts a new "refinancing" fee. The Ministry believes this practice does not reflect the intent of Part 2 subpart 8 in that a genuine hardship application should be of benefit to the consumer.

Accordingly, it is proposed that the CCCFA provide that fees may not be charged for applications for hardship, including the actual consideration of the application and any follow-up required, such as being sent a letter outlining the variations made to the credit contract. As well, it is proposed that if a consumer, upon an application for hardship or other signal of distress to a lender, subsequently decides to refinance a loan (i.e. takes on more credit from the initial lender) then a refinancing fee cannot be charged.

Not allowing the charging of fees for hardship applications promotes the policy intention of the CCCFA to provide relief to borrowers in a stressful situation without adding to the existing debt. This proposal will also act to prevent unscrupulous lenders from taking advantage of already distressed consumers.

Proposal

The CCCFA provides that:

- fees may not be charged for applications for hardship under the CCCFA. This includes the actual consideration of the application and any follow-up required, such as being sent a letter outlining the variations made to the credit contract; and
- if a consumer, upon an application for hardship subsequently decides to refinance a loan (i.e. takes on more credit from the initial lender) then a refinancing fee cannot be charged.

Q.12

- Do you agree that hardship application fees should not be permitted?
- Should refinancing fees not be permitted when a consumer is in a situation of unforeseen financial hardship?

Disclosure of information about unforeseen hardship to consumers

Community agencies have commented that while some consumers are aware of the hardship provisions and the ability to seek contract variations, the majority of their clients are not aware.

Providing consumers this information upfront in the loan contract, by means of the compulsory disclosure requirements of the CCCFA, may be a means of increasing awareness and promoting a more proactive borrower response to circumstances of unforeseen hardship. Borrowers need to know that they can apply for hardship variations under the CCCFA. Better awareness of these provisions is likely to benefit both borrowers and lenders by enabling parties to make suitable arrangements for servicing of a debt.

Experience has shown that consumers are more likely to read their credit contract when they know they cannot make payments and want to find out what will happen to them. Having the information in the disclosure statement may draw their attention to the relief provisions available and facilitate greater access to them.

Providing hardship information in this way is similar to that of the Consumer Information Notice, which must be provided to a consumer when they purchase a used motor vehicle from a motor vehicle trader. This Notice has a description of consumer rights which both raises awareness of those rights generally and can be referred to when things "go wrong".
The cost to lenders of including this information in the required disclosure for credit contracts should be minimal.

Proposal

Accordingly, it is proposed that information on the hardship provisions and how to apply for them be included in the disclosure requirements of the CCCFA.

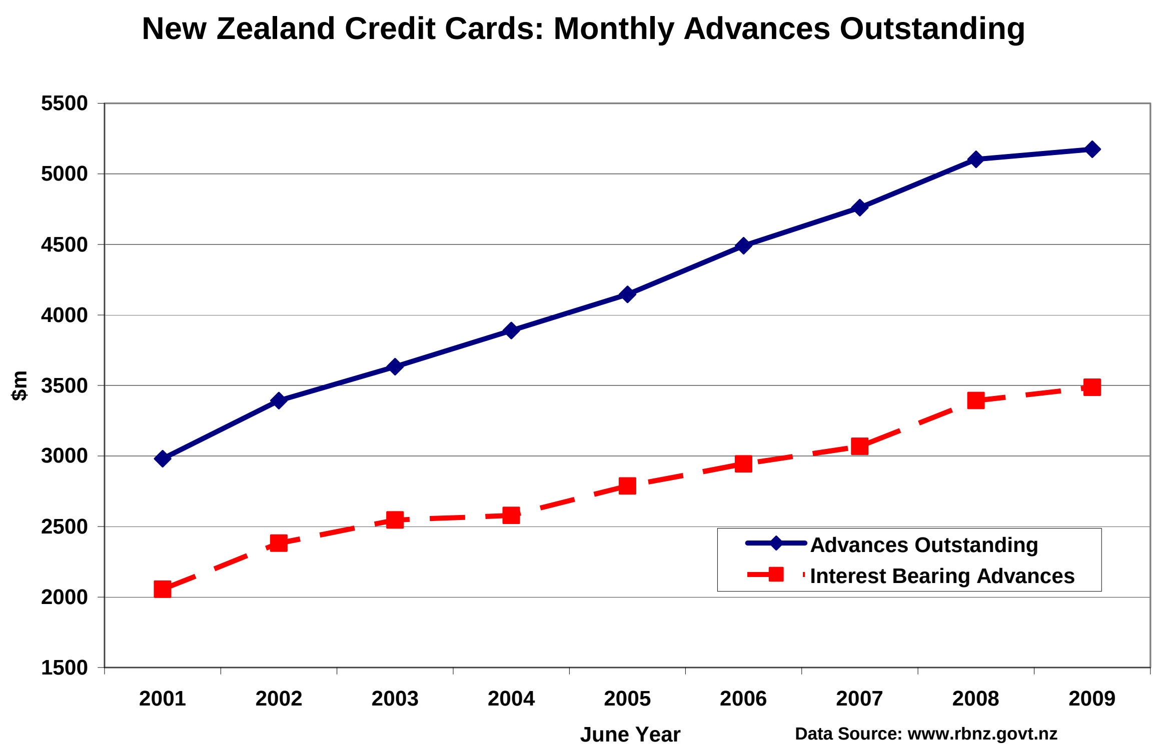
Q.13

- Do you support the addition of information in the credit contract disclosure about hardship applications?

6. Unsolicited Credit

Background

Credit cards and finance cards are a widely used form of credit. There has been a significant increase in the use of such cards over the last 10-20 years.



Credit cards are issued by providers such as banks and major retailers upon application from a consumer. Credit cards are issued with a defined credit limit. Each month, the consumer may use the credit card up to its limit and then within a defined period a minimum amount is required to be repaid and any outstanding amounts not repaid are credit on which interest accrues.

From time to time, the credit card provider may advise the credit card holder (the consumer) that they are increasing the credit limit available unless the consumer advises the new limit is not wanted.

An alternative approach is to advise the consumer that the credit card limit may be increased if the consumer replies agreeing to the new limit. The former practice was very prevalent and came in for considerable criticism in the media and from community organisations. The latter practice is now more common but the former practice still occurs.

Finance cards are typically supplied by finance companies that have relationships with national appliance stores. They can be used at various stores and ATM machines.

These cards are not generally requested by the consumer. The consumer enters into a credit contract, for example, to obtain a television on a no-interest, long term credit contract arranged by the appliance store. A few weeks later, a letter and finance card is mailed to the consumer advising of an extension of credit available under the credit contract which may be accessed by using the finance card. Essentially, the finance card allows the consumer to borrow more money than that covering the no-interest transaction, sometimes more than double the original loan amount.

When used beyond the no-interest amount, these cards immediately incur interest charges.

Discussion

The extension of credit card limits or finance card limits without the express agreement of the consumer is a form of unsolicited credit.

Behavioural economics indicates that people tend not to opt-out when given a choice that something will occur unless you expressly indicate otherwise. Unsolicited "selling" takes advantage of this inertia.

Unsolicited credit and finance card increases would appear to provide easy access to additional credit and to encourage some consumers to take on excessive debt.

The Banking Ombudsman has reported many instances of credit card increases being provided to persons completely unsuited to managing the extra credit.

On the one hand it is important to allow freedom in credit provision and to allow new and innovative approaches to address the variety of consumer demands. On the other hand, unsolicited credit can cause consumer detriment by encouraging over-borrowing. One approach that still allows for finance providers to offer extended credit is to require that credit limit increases may be made only by opt-in. In other words, a consumer must actively consent to an increased credit limit. This suggestion is not intended to prevent the consumer from at any time making a direct approach to the lender seeking an extension of credit.

This would mean credit contracts could not include clauses that provide for the lender to automatically increase the credit limit; and a finance card or store card could not be issued for above the original limit as agreed in the credit contract until the lender has received the active opt-in from the consumer.

Proposal

Consideration should be given to restricting unsolicited credit and finance card increases such that credit limit increases can only be made when the borrower has actively opted-in. This should be made at a time after the original commencement of the credit contract. (In other words, contracts cannot in the first instance provide for future unsolicited extensions of credit. The opt-in must come at a later time period.)

Q.14

- Do you agree that credit and finance card limit increases should be opt-in only?
- Should there be a timeframe from when the credit is first arranged to when the lender can make an approach with a limit increase?

7. Oppressive Conduct

Background

A stated purpose of the CCCFA is to prevent oppressive credit contracts, consumer leases and land buy-back transactions (contracts), and oppressive lender behaviour under those contracts.

The CCCFA provides for a remedy where a party to the contract has behaved in an oppressive manner either through conduct or contractual conditions. The Act defines oppressive as "oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice". The CCCFA's oppression provisions were carried forward into the Act from the previous Credit Contracts Act 1981.

The rationale behind these provisions is to provide a means of relief to parties to the contract from being subject to oppressive conditions. This is considered particularly important in situations where borrowers are in desperate need of money and will agree to any terms or where they are not sufficiently aware or capable of determining the implications of certain clauses.

These provisions enable the Disputes Tribunal or the Court to reopen a contract if they consider that a contract is oppressive, a party has or intends to exercise a right under the contract in an oppressive manner, or where a party has been induced to enter the contract by oppressive means. Where the Disputes Tribunal or the Court finds oppressive conditions or conduct, it may vary those conditions in the contract and award compensation. Any affected party may take a case to the Disputes Tribunal or the Court. The Commerce Commission also has an enforcement role in relation to oppression.

In addition to the CCCFA's oppression provisions, the Disputes Tribunal Act 1988 gives the Tribunal the ability to rule on any contract that may have been exercised in a harsh or oppressive manner (section 19 (1)(e)).

How the oppressive conduct provisions are working in practice

Few cases have been heard by the courts in the area of oppressive contract terms and behaviour so there is little precedent (case law) that the Commerce Commission and community agencies can rely on to assist in enforcement.

The rulings that have been made by the Courts indicate that oppression is a relatively high test and that unfair or unjust terms or actions are not necessarily oppressive. In addition to unfair or unjust contract terms, oppression requires wrongdoing in the application or enforcement of those terms. As well, the cases heard by the Courts (and the Disputes Tribunal, where findings are accessible) suggest that cases are likely to be dependent on the individual circumstances of the affected party.

Cases that have been considered by the Disputes Tribunal are not generally published in accordance with the privacy principles as provided in section 39 of the Disputes Tribunal Act. This makes it difficult to assess how the oppression provisions are working and being interpreted in this forum. Community agencies have raised with Parliament's Justice and Electoral Committee, the Minister of Consumer Affairs and the Minister of Justice, the possible publication of Disputes Tribunal decisions. The Justice and Electoral Committee has recommended a review of the Disputes Tribunals Act to consider this matter. This review is supported by the Minister of Consumer Affairs.

The Law Commission, in its paper *Tribunals in New Zealand*, has also recommended public access to Tribunal hearings and reports of proceedings should be permitted, unless a public interest requires otherwise.

If there was some publication of the reports of proceedings, it would improve transparency of the Disputes Tribunal and could assist or inspire consumers to seek redress for oppressive contract conditions or behaviour.

Community agencies consider there are many contracts and practices in the credit market, especially in the fringe sector, that are unacceptable in that they are unfair or unjust and have an adverse impact on borrowers. Examples are:

- inducing payments by:
  - holding of passports and bank cards (eftpos cards etc);
  - public disclosure of personal information – to family, employers, churches;
  - threatening to take or taking of essential household items, such as beds, toys and whiteware; and
  - public shaming of loan defaulters into payment by publishing their photo in local newspapers;
- contracts with unilateral clauses allowing the lender to change conditions at will; and
- security agreements that capture all of a borrower's assets.

These practices may not satisfy the high test of oppression. In other jurisdictions, for example the United Kingdom and Victoria, Australia, there is unfair contract terms legislation. This legislation typically applies to standard term contracts where the consumer has little ability, if any, to negotiate or influence the contract terms. Australia, this year, decided to have unfair contract terms legislation as part of its new national consumer law.

Consideration is being given to including in the Fair Trading Act 1986 a prohibition on unfair contract terms, as part of the Ministry of Consumer Affairs major consumer law review referred to as "One Law, One Door". It is anticipated many of the practices that might be considered unfair but do not quite fall within the definition of oppression under the CCCFA may fall within the ambit of unfair contract terms.

Whilst the test for oppression can be considered a high test, the meaning in section 118 referring to oppression as being "in breach of reasonable standards of commercial practice" is sufficiently clear that illegal provisions in contracts and use of threatening behaviour would not be considered to be reasonable standards of commercial practice and thus the credit contract or behaviour of the creditor regarding the contract may be found to be oppressive. Where such practices are identified, the Commerce Commission is able to take action.

The Ministry has concluded that the oppression provisions in the CCCFA are functioning as intended. Consequently, no amendment proposals are suggested.

8. The Credit (Repossession) Act 1997

Background

The Credit (Repossession) Act 1997 sits alongside the CCCFA. It covers the repossession procedures and processes that a creditor (or agent) must follow for all secured loans and hire purchase agreements over consumer goods.

In other words, if a person has a credit contract which provides that property can be obtained when default of payment occurs, then the Credit (Repossession) Act applies. The Act also regulates who may be a repossession agent. The Act is self-enforcing, in other words a person who is affected by actions claimed to be made under the Act must challenge the actions with the Disputes Tribunal, District or High Courts.

The Credit (Repossession) Act addresses a very difficult area of law involving finding the appropriate balance between the rights of creditors and consumers when in a situation of unpaid credit. It provides a number of very powerful rights to credit providers. For example, the Act provides that where there is an unpaid credit, repossession agents have the right to enter homes and take possession of consumer goods within broadly prescribed times. The agent may use reasonable force when the home is unattended and leave the home unsecured.

A creditor's right (or their agent's) to enter a property and repossess goods owned by a defaulting debtor comes from the security clauses in their credit agreement under the CCCFA. This is a private contractual right, the enforcement of which is upheld by the Credit (Repossession) Act and the Personal Property Securities Act 1999.

The CCCFA regulates the fees, interest, insurances and information that must be disclosed in consumer credit contracts. It does not directly regulate the form and extent of security that may be taken by creditors in consumer credit contracts, but it does give the courts re-opening powers under its oppression provisions, which may assist debtors with particularly onerous security clauses.

Security clauses must be drafted in enough detail to identify the collateral. If creditors take goods that belong to someone other than the debtor, or which are not included in the security agreement, they are likely to commit the tort of conversion[6]. The owner or person in possession of the converted goods can sue and recover the value of the goods. If the creditor knowingly takes the goods, they may also commit theft.

The Credit (Repossession) Act replaced procedures for the enforcement of securities under the Hire Purchase Act 1971, the Chattels Transfer Act 1924 and the Motor Vehicle Securities Act 1989. Prior to the Credit (Repossession) Act, a consumer in default of a credit agreement was subject to coercive, expensive repossession and enforcement procedures. They had no recourse to the creditor for losses except in those few cases where they could invoke the reopening provisions of the Credit Contracts Act 1981.

[6] Conversion is "the unjustified taking or removal of another's goods with the intention of asserting dominion over them." In other words, the assertion of a right to take goods when no such rights exist, in interference of another's rights in the goods. Todd, "The Law of Torts in New Zealand" (2nd Ed) (1997) 623.

How the Credit (Repossession) Act is working in practice

The effectiveness of the Credit (Repossession) Act 1997 has been called into question by consumer groups, the Insolvency and Trustee Service and the Commerce Commission. For example, consumer organisations have commented that the rights under the Act are powerful and intrusive.

Repossession of security - All Present and After Acquired Property Clauses

A particular problem is the intersection of the CCCFA and the Credit (Repossession) Act with respect to overly broad security clauses contained in the contracts of some consumer credit providers (creditors). These "dragnet" clauses purport to allow the creditor to direct repossession agents to take all and any goods from the homes of borrowers who are in default of payments on their credit contracts and to return to take more household effects if the sale of these goods does not clear the debt. These clauses are also referred to as All PAAP – all present and after acquired property – clauses.

The Ministry of Consumer Affairs' recent case files and anecdotal information from community organisations, the Insolvency and Trustee Service and, in one case, from a repossession agent, indicate what would appear to be an increased use of dragnet security clauses which are causing considerable financial hardship, fear and distress for some consumers.

As noted above, the CCCFA does not directly regulate the form and extent of security that may be taken by creditors in consumer credit contracts. Rather, regulation of security falls under the Personal Property Securities Act (PPSA). The PPSA is concerned with the determination of priority between security interests and other types of interests in personal property and operation of the registry. Section 44 of the PPSA is relevant to consumer credit in that it specifically provides that a security interest in after-acquired property does not attach to consumer goods, except where those consumer goods replace the collateral described in the security agreement or the security interest in those consumer goods is not a purchase money security interest[7]. Unfortunately, the application of section 44 to consumer goods either is not widely understood or is being misinterpreted in respect of consumer credit contracts.

Not only are consumer credit contracts with clauses purporting to take a security interest in all present and after acquired property (All PAAP) a likely breach of section 44 of the PPSA, but also by including such clauses in consumer credit contracts, creditors are likely to be in breach of section 13(i) of the Fair Trading Act 1986, as they have misrepresented their rights and remedies to the borrower.

At this stage, no prosecutions have been taken against creditors under the Fair Trading Act for including All PAAP clauses in a consumer credit contract.

The following examples of practices are noted:

- security clauses are imbedded in contracts and not specifically brought to debtor's attention;
- security agreements are not being drafted with sufficient detail to identify the collateral;

[7] In other words, the after acquired property was bought with the proceeds of other secured collateral (e.g. the debtor sold the goods they listed as security and bought something else with the money) or with the advances paid under the finance agreement or if the after acquired property is installed in or affixed to the security collateral. In any other case the debtor must nominate any future property before it can form part of the collateral.

- lenders take security over essential household goods with low re-sale value and cultural items because of the emotional leverage they provide, rather than re-sale value.

As discussed above, there is a problem with some credit contracts containing All PAAP clauses. There is also a further problem regarding how creditors approach enforcing these clauses. As noted, before a creditor can seize consumer goods under a security agreement they must comply with the procedures set out in the Credit (Repossession) Act. Before goods can be seized a creditor must send a pre-possession notice which, among other things, describes the goods they intend to take. If they cannot properly describe the goods they cannot take them. A statement such as "all personal property" does not describe the goods in sufficient detail. Following repossession, a post-possession notice must be forwarded advising the debtor of how to settle or reinstate the agreement and get the goods back and what happens if the agreement is not settled or reinstated.

It would appear that post-possession procedures required by the Credit (Repossession) Act are frequently insufficiently completed by the creditor or are not delivered to the debtor who generally does not know what their rights are. This results in the debtor not being able to obtain a pre-sale valuation of the repossessed goods in order to take up the option to reinstate the agreement, introduce a cash buyer or allow the sale to proceed.

This action is not being challenged because debtors generally lack both the resources and knowledge of the law. As noted, the Credit (Repossession) Act is self-enforcing.

A further issue concerns repossession from debtors who have entered into a No Asset Procedure (NAP). The Insolvency and Trustee Service is receiving calls for help from NAP debtors who have had all their property taken or are being threatened with this action by a creditor. The Insolvency and Trustee Service is concerned that while the NAP provisions aim to enable debtors to have a fresh start financially and be able to return to contributing to the economy, the actions of creditors in continuing to pressure debtors to repay for fear of losing household effects means the objective of the NAP legislation is being undermined.

One option to the above issues is to provide in the CCCFA that the initial disclosure requirements under Schedule 1 (Key information concerning consumer credit contract) include itemised disclosure or other sufficient description of any personal property owned by the debtor which will be taken as security upon default of the credit contract. The suggestion is that this is supplemented by requiring the Credit (Repossession) Act to include that personal property cannot be seized unless it has been itemised or otherwise sufficiently described in the security agreement (consumer credit contract), and on any pre-possession notice (which must currently be sent to the consumer before any goods can be taken).

Strengthening the disclosure requirements in this way will also allow the Commerce Commission to have more direct enforcement of repossession clauses in credit contracts.

These amendments do not prohibit borrowers from putting up items they own as security for credit contracts. People will still be able to freely enter into secured credit contracts but when they sign them they will have to specifically itemise the property they wish to use for security. This will give the borrower the opportunity to consider the implications of the loan.

The effect of requiring itemised security is that only security identified as such is able to be taken. This will help prevent the illegal taking of another person's property such as that of a flatmate, boarder or family member who is not a party to the contract. This may also assist Police who occasionally attend repossessions to be sure the items being repossessed are only those subject to the contract.

It should also help to prevent situations where, for example, children's clothing, beds, toys and other essential appliances such as ovens are used as security without the explicit consideration of the borrower that they possibly may be taken.

Proposal

Accordingly, it is proposed that:

- The CCCFA is amended to require in the credit contract itemised disclosure or other sufficient description of any property over which the creditor has a security interest; and
- The Credit (Repossession) Act is amended to include that personal property cannot be seized unless it is itemised or otherwise sufficiently described in the security agreement (consumer credit contract), and on any pre-possession notice (which must currently be sent to the consumer before any goods can be taken).

Q.15

- Should there be more specific disclosure of personal property that may be taken as security by a creditor if a debtor is in default in the credit contract?
- Should the Credit (Repossession) Act provide that personal property cannot be seized unless it has been sufficiently described in the security agreement?

Credit (Repossession) Act 1997: General Operational Issues

A number of general issues with the Credit (Repossession) Act have been identified by community organisations, such as the Community Law Centres and Citizens Advice Bureaux, and the Ministry of Consumer Affairs. These are outlined below.

1. Contractual right to enter a premises - no penalty for trader non-compliance with Part 3 of the Credit (Repossession) Act

Section 14 of the Credit (Repossession) Act requires that creditors and their agents must not exercise the right to enter premises in an unreasonable manner and, in accordance with section 15, must not enter outside the hours of 6 am to 9 pm, Monday to Saturday; or on a public holiday or Sunday. A borrower can consent in writing for a creditor to enter premises outside of these hours but the consent is only valid if it is given after default and before the creditor takes action to repossess.

Section 17 of the Act further requires that if someone is home at the premises, creditors and their agents must produce a copy of the pre-possession notice (unless the goods are at risk), must prove they have authority to repossess goods, and, where applicable, produce written consent to repossess outside prohibited hours.

Section 18 entitles creditors and their agents to enter a premise, when the occupier is not present, provided they leave a note in a prominent place advising that repossession has taken place. The note has to state the date on which repossession occurred, a list of the goods that were taken, a copy of the pre-possession notice and the authority to repossess (and if outside prohibited hours, a copy of the written consent).

Section 18 also requires creditors and their agents to take such steps as are reasonably practicable to ensure that the premise is not left obviously open.

There is a body of anecdotal evidence to suggest that repossession agents may push the boundaries when exercising the power to repossess. For example, the Ministry of Consumer Affairs has received complaints about agents walking into homes without knocking first, abusing household members and non-provision of the pre-possession notice. Such entry is unreasonable behaviour under the Act. Other behaviour includes taking property which is not included in the security agreement (including that not owned by the debtor) and the requesting of sexual favours has been reported.

The Credit (Repossession) Act has no offence provision for non-compliance with any of the above sections. This means there is no incentive for creditors or their agents to ensure repossessions are carried out during the prescribed times, in a reasonable manner, or that premises are left secure. This can leave consumers and debtors with no avenue for redress.

Community organisations argue that an express statutory recognition of the consequences of an invalid repossession should be introduced into the Credit (Repossession) Act. They argue that creditors would be less likely to ignore the procedural requirements if they knew there were consequences. One suggestion is to make non-compliance an offence, which renders the repossession invalid.

2. Creditor must not enter premises in "unreasonable manner"

The Credit (Repossession) Act does not provide guidance about what constitutes an unreasonable manner with respect to entering premises (section 14), making it difficult for consumers to assess when they are entitled to obstruct repossession agents, or claim compensation for damages incurred as a result of either removing goods or entering the premises when unoccupied.

While some conduct, such as abuse, is obviously unreasonable, the situation is unclear when the consumer has reasonable doubts about the validity of the repossession and/or wants time to seek legal advice. In most cases the repossession agent is acting on strict instructions from the creditor. They may not know whether a security agreement is enforceable and the creditor has followed the correct procedures for initiating repossession; or be willing and able to assess whether the debtor has grounds for resisting or seeking to delay the repossession.

Community organisations note the right under the Credit (Repossession) Act to enter homes and take possession of consumer goods and to use reasonable force when the home is unattended and leave the home unsecured is comparable to a landlord's right to enter a property and seize certain chattels of a tenant as security or in payment for rental arrears (Residential Tenancy Act). However, with residential tenancies, this right can only be exercised pursuant to an order from the Tenancy Tribunal. If such an order is not obtained, a landlord may be liable for compensatory and exemplary damages.

In comparison, there is no equivalent entity that oversees actions taken under the Credit (Repossession) Act. The Act places the onus on debtors to avoid repossession and any losses resulting from a creditors' conduct. Community organisations would like to see some equivalent independent authority for credit repossessions which would then occur only after an order from such authority.

The independent authority would not necessarily have to be a formal institution. Persons such as a Justice of the Peace or a warranted officer could possibly be used.

3. No liability on creditor or their agent if an employee is disqualified under section 16

Section 16 of the Credit (Repossession) Act disqualifies a person from repossessing goods if they have been:

- convicted in the last 5 years of any offence involving violence against the person, or any dishonesty crime under section 2 of the Crimes Act 1961;
- sentenced, at any time, for a term of imprisonment of 10 years or more or for life; or
- released from prison in the last year.

Any person that breaches this section will commit an offence and will be liable, on summary conviction, for a fine of up to $10,000.

The Credit (Repossession) Act, however, does not penalise either the creditor, or their agent, if their employee fails to comply with section 16. This effectively means there is no direct incentive for the creditor to ensure their agent acts according to the requirements of section 16.

Community organisations suggest some creditors and their agents may be deliberately choosing not to enquire if employees meet the criteria of section 16 and also note that persons disqualified from being a repossession agent may not be aware of the employment restriction imposed by section 16 and unwittingly commit an offence under the Credit (Repossession) Act.

Providing that creditors and agents must have some responsibility for the employment of suitable repossession agents would improve compliance with section 16.

As well, a specific requirement for police vetting could be an option to improve the make-up of the industry. Given it is common for businesses to require prospective employees to provide character references, disclose convictions and undergo a police vetting/checking process this could be made compulsory for all those who repossess under the Act. This could possibly be done along the lines of the licensing requirements for auctioneers or secondhand dealers and pawnbrokers. The costs associated with Police vetting are minimal and should also have minimal compliance impact on creditors and their agents.

4. Non-compliance with the procedural requirements of Part 4 of the Credit (Repossession) Act

Part 4 of the Credit (Repossession) Act outlines the procedure to be followed after the creditor takes possession of goods. This includes the requirement to serve a post-possession notice on the debtor and any guarantor of the debtor within 21 days of the repossession.

Section 22 provides that if the creditor fails to serve a post-possession notice on the debtor within 21 days of repossession, the creditor must bear the costs of taking possession of the goods. Non-compliance with this section does not invalidate the repossession, or prevent the creditor from selling the repossessed goods.

Section 24 provides that where a creditor sells the repossessed goods within the post-possession notice period of 15 days, the debtor's liability for anything other than the amount financed or the performance of the secured obligation is extinguished.

The purpose of the creditor completing and serving a post-possession notice is to put the debtor on alert as to the likely sale price of the goods, collection fees and balance left owing. The debtor can then elect whether their best option is to reinstate the agreement, or allow the sale to proceed. Including the estimated value also helps the debtor exercise their right to introduce a cash buyer and may provide guidance if the creditor has not taken reasonable steps to obtain market value for the goods.

The Ministry of Consumer Affairs regularly receives complaints from consumers who feel the post-possession notice has been insufficiently completed by the creditor, in particular the creditor's estimated value of the goods. There are no penalties under the Credit (Repossession) Act for the creditor if they do not complete the form correctly (or simply do not complete the form).

The Act allows the debtor the opportunity to challenge the estimated value a creditor places on the repossessed goods, by entitling them to obtain a pre-sale valuation at their own expense. Debtors cannot take advantage of this opportunity if the post-possession notice is incomplete or not delivered at all.

Section 26 requires creditors to ensure that every aspect of the sale is commercially reasonable and that all reasonable efforts have been used to obtain the best price. The creditor must also give the debtor reasonable notice of the auction (including the time, place, existence and amount of any reserve price), or public tender. The creditor bears the onus of proving they have complied with this section.

The Credit (Repossession) Act is silent on what should happen when the debtor's valuation of their security is higher than the creditor's. Debtors will have difficulty convincing a creditor that their valuation is correct; and the goods are potentially able to be sold before the Disputes Tribunal or the Court can hear the debtor's argument.

There is anecdotal evidence to suggest that this is a particular problem with the repossession of motor vehicles which are a commonly repossessed item. The Ministry identified an instance where a car valued at $17,000 on purchase was repossessed two years later and sold for $1,000 – with the vehicle needing $1,000 in repairs to make it warrantable, effectively selling the vehicle for free.

5. Lack of clarity in relief provisions – sections 12 and 13

Section 12 of the Credit (Repossession) Act allows a debtor to seek relief from a Court (including the Disputes Tribunal) if the creditor sends a pre-possession notice or repossesses goods in contravention of the Act. Section 13 defines the powers of the Court to grant relief.[8]

Community organisations note that the right to apply for relief is contingent on a contravention of the Act. They suggest this is an unusual approach to a relief provision and that ordinarily the remedy for unlawful breach is compensation for losses suffered as a result of the breach. They suggest a statutory grant for relief from hardship is usually a discretionary remedy, rooted in equity, awarded to relieve the applicant of a burden that flows from **lawful** events.

Accordingly, the community organisations have suggested an amendment to enable the debtor to seek relief when repossession is commenced either lawfully or unlawfully.
The suggestion is that section 12 cover situations where:

- the debtor suffers hardship; or
- the debtor has built up a substantial equity in the goods; or

[8] Section 13 also provides that where the debtor's application is vexatious the Court must order the debtor to pay the full costs, fees, and expenses incurred by the creditor. The creditor may also sell the goods at any time, and the debtor loses the right to introduce a cash buyer for the goods.

- some unusual or extraordinary circumstance has occurred; or
- security leverage is disproportionate; or
- it is equitable and just to give the debtor time to pay.

6. Enforcement of the Credit (Repossession) Act

Repossessions under the Credit (Repossession) Act are not specifically monitored by any enforcement agency. Police are sometimes called to repossessions for the purposes of keeping the peace rather than determining any rights of the parties.

While some complaints are taken to the Disputes Tribunal about Credit (Repossession) Act matters, disputes about the lack of a pre-possession notice and poor general practice by creditors commonly fall through the enforcement gap.

The gap also includes the lack of action taken by consumers themselves. Unlike the situation where a confident consumer takes back a faulty good and self asserts their rights under the Consumer Guarantees Act, a repossession situation is likely to be one of distress for the debtors. They may be more concerned about other matters which have led to the repossession or the actual repossession itself and may not be of frame of mind to inform themselves of their rights and take action.

A possible option is that the Commerce Commission be given responsibility for enforcement of the Credit (Repossession) Act. This could be done by incorporating the Credit (Repossession) Act into the CCCFA or having it continue as a standalone piece of legislation.

The primary justification for including the Credit (Repossession) Act under the CCCFA would be to enable the Commerce Commission to enforce repossession law. A case can be made that an active "watch dog" who examines the behaviour of repossession agents would result in better outcomes for consumers.

Having the Commerce Commission enforce the Act might not necessarily improve the rate at which consumers raise complaints but it would put the credit repossession industry on notice and they would be encouraged to behave more in accordance with the Act. Consumers who understood there was an avenue to which complaints could be taken, would perhaps be more empowered to self assert their rights against a creditor.

Proposal

Consideration should be given to amendments to the Credit (Repossession) Act, including:

- strengthening enforcement of the Act, possibly by providing for enforcement by the Commerce Commission and adding penalties for non-compliance of the entry onto premises and repossession notices provisions in the Act;
- requiring an independent authority to make an order allowing a repossession such as a Justice of the Peace or warranted officer;
- making creditors and agents responsible for ensuring any person repossessing goods on their behalf is not disqualified and requiring police checking that a person is not disqualified;
- improving the procedures for voluntary return of goods; and
- allowing a debtor to seek relief from the Court from a repossession.

Please note that these suggestions are made following a very limited assessment of the operation of the Credit (Repossession) Act based on complaints and observations the Ministry of Consumer Affairs has received.

Q.16

- Does there need to be enforcement of compliance with the Credit (Repossession) Act by an agency such as the Commerce Commission?
- Is there the right balance between creditor and debtor rights in the Credit (Repossession) Act?
- Should a creditor be required to seek an order from an independent authority or warranted officer before commencing a repossession?
- Do there need to be more penalties to ensure compliance with the Credit (Repossession) Act entry onto premises and repossession notice provisions?

Part Two: Review of Fringe Lending Practices and their Mitigation

9. Fringe Lending Practices

This part of the discussion paper discusses particular concerns with lending practices at the margin, referred to as fringe lending practices. These practices have been identified as having a detrimental effect on borrowers, and range from very high interest rates to harsh conditions that the borrower feels unable to question. As noted, the review of the CCCFA has concluded that the CCCFA is not as effective as desired in addressing those undesirable fringe lending practices which are mainly, but not exclusively, engaged in by fringe lenders operating in lower socio-economic communities.

The CCCFA is based on the premise that well informed consumers are best placed to make borrowing decisions that are optimum given their own particular circumstances. This is reflected in the disclosure-based character of the CCCFA. The CCCFA implicitly assumes that consumers should be responsible for the decisions that they make, for good or for bad.

Despite the availability of information, in some situations, consumers make what would generally be regarded as poor financial decisions, resulting in excessive debt and/or excessive costs (interest repayments and penalty charges). Of particular concern are those credit providers who exploit poor decision-making, resulting in consumers being much worse off than if they had not had access to credit. These practices have been highlighted by community groups, through complaints to the Ministry of Consumer Affairs, and were identified in the 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets.*

The 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets* noted some very positive stories about how Pacific people manage their finances and that it appears most loans are repaid; but that the overall picture is of the need to access cash loans and an inability to access cheaper credit options (for example, for car purchases), leaving borrowers exposed to high cost and exploitive credit contracts (p. 13, p. 105). The conclusion of the report noted that everyday borrowing [from fringe lenders] has produced an environment of continuing pressure and stress in the lives of Pacific consumers (p.106).

For those not managing debt well, the consequences of poor decision-making can be significant for individuals and families.

Internationally, problems with fringe lending practices are also evident in countries such as Australia, United Kingdom, Japan, USA, and Canada and are receiving policy attention.

The 2006 *Fringe Lenders in New Zealand Desk Research Project* concluded that those engaged in fringe lending practices are likely to share some of the following features (p.14):

- specialise in personal cash loans and immediately available cash[9];
- target specific communities (particularly ethnic communities, beneficiaries, low income neighbourhoods and those with poor credit ratings);
- provide less flexible terms and conditions, few credit checks and little paperwork to fill out;

[9] The 2006 Fringe Lenders in NZ desk research project found 94% of those defined as fringe lenders specified they offered cash or personal loans.

- provide limited documentation or overly simplified contracts (which is often promoted in their advertisements);
- charge higher interest rates than mainstream lenders;
- charge large administration fees out of proportion to the size of the loan (may include establishment, security inspection, documentation and loan shortfall insurance policy fees); and
- are small, often owner-operated.

Fringe lending advertising

The research looked particularly at advertising by fringe lenders. It found that fringe lenders market themselves as sources of easy credit. Similarly, the 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets* noted the most popular reason given for using fringe lenders was the ease of obtaining the goods or cash from these sources (p. 49).

From the research and also discussions with community groups the following general observations are made. Fringe lenders advertise that they are "not like a bank" and therefore more willing to lend. The fringe lender is probably not concerned that the bank will not allow an overdraft; they might not be concerned that someone has overdue fines (or other financial commitments). They are more interested in making the customer a long term client. The borrower will know they are likely to get the money they need right away and likely will be able to leave with cash in hand. Arrangements for loans can be made in person or by telephone. The 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets* notes that if someone is a "good payer they will become valued customers with more offers of loans from the finance company" (p.49).

Loans can be sought for anything. Commonly loans are known to be made for vehicle purchases (often arranged via the motor vehicle trader), household appliances, or unexpected situations such as health care treatment or a funeral.

The 2006 *Fringe Lenders in New Zealand Desk Research Project* showed that about half of the identified fringe lenders (51%) advertised in local and community papers. Of the community newspapers searched 69% had one or more advertisements for fringe lenders. Advertisements were also targeted at specific ethnic community newspapers, both Pacific and Asian. There is less likely to be advertising on television although some television advertising has occurred offering "help" for situations such as unemployment, utility debt and funeral expenses. Iwi radio and stations such as Mai FM and Niu FM have also been used.

The 2006 *Fringe Lenders in New Zealand Desk Research Project* found the following common features of advertisements for fringe lender services:

- **Placement**. The majority of advertisements in the community newspapers are placements within the "financial" section of the classified directory towards the back of the paper rather than large individual spots in the main pages of the paper. The exception to this is in the ethnic newspapers where the reverse applies.
- **Simplicity**. Almost all fringe lender advertisements emphasise the effortlessness and speed of applying for and getting a loan.
- **Flexibility**. Advertisements often make it clear money can be borrowed by almost anyone (regardless of circumstances or past history), for almost any purpose.
- **Affordability**. Many advertisements emphasise how low repayments can be and hence how affordable their loans are.

- **Commonality**. Advertisements sometimes use people of similar ethnicity to their target market and also employ the "personal touch" (e.g. printing the first names and photographs of their lenders/staff, and using phrases such as "friendly team", "be part of the family", "personal service", "when you need a friend with cash to spare").
- **Incentives and disincentives**. Some advertisements use incentives to encourage consumers to borrow from them (e.g. the chance to win a "holiday getaway" with approved loans). Disincentives such as publishing the names and photographs of loan defaulters may also be employed by some lenders.

Pay day lending

Pay day lending which is the practice of lending a small amount of money, with the obligation to repay the money at the next pay cycle, is a particular form of fringe lending practice. Pay day loans are often sought for financial emergencies, such as paying the bill before the power or telephone is cut off, or for short term needs such as grocery items.

The practice with a pay day loan is for the lender to charge a fee for this small loan which is effectively an extremely high annual interest rate. The pay day lender will allow the initial pay day loan to be rolled into the next cycle if the obligation is unable to be met. This results in another charge and the consumer is at risk of potentially falling into a cycle of pay day lending, and always in debt to the lender.

As part of the policy development which led to the development of the CCCFA, the Ministry of Consumer Affairs tried to undertake an assessment of pay day lending in New Zealand. At that time (early 2000) it was not a visible lending form. Anecdotal evidence suggests there is now more pay day lending occurring and there is quite visible advertising of pay day lending, including in the Yellow Pages.

The 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets* noted pay day lending as a relatively new lending scheme reported as being widely promoted. It cited a particular example of "pay week advances" and commented that a number of similar cases were reported (p.78).

There has not been an analysis of the characteristics of pay day lending in New Zealand. The Centre for Responsible Lending, an American based policy group, has found the characteristics of American pay day lenders include the following:

- Short minimum loan terms: 75% of pay day customers are unable to repay their loan within two weeks and are forced to get a loan "rollover" at additional cost. In contrast, small consumer loans have longer terms.
- Unlike most consumer debt, pay day loans do not allow for partial instalment payments to be made during the loan term. A borrower must pay the entire loan back at the end of two weeks. (In New Zealand, the CCCFA requires the lender to accept prepayments unless the contract expressly allows them to be declined (section 49(1).)
- Loan flipping (extensions, rollovers or back to back transactions). Pay day lenders earn most of their profits by making multiple loans to cash-strapped borrowers. 90% of the pay day industry's revenue growth comes from making more and larger loans to the same customers.

The 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets* pay day lending example notes the person seeking the loan needed money for groceries due to lower wages than expected. The finance company tried to loan more than requested. For the $100 loan obtained,

$16 interest was charged and an administration fee including a credit check of $32, resulting in $138 paid for a one week loan (p.78).

Mobile Shops / Clothing Trucks

Mobile shops and door to door operators target low income groups and are commonly found in low income areas of places such as South Auckland, Christchurch, East Cape and the West Coast.

Mobile shops used to focus mainly on clothing and to some extent appliances, but in recent years have moved into high priced items, such as computer systems and furniture, and basic essentials, such as food. They are typically known as "clothing trucks". Customers are able to pay for their purchases using credit provided by the mobile shop. Customers who purchase items on credit are required to sign up to regular automatic payments or direct debits. These arrangements are subject to the CCCFA.

The benefit of clothing trucks is they provide a service for those consumers who are housebound, without access to transport, or for some other reason are less able to shop at retail stores. Trucks provide a way of getting goods to those consumers in a convenient and timely manner.

Anecdotal evidence suggests that goods from mobile trucks are sold at three or four times the price that people would normally pay in a retail outlet. Payments are typically made through automatic payments. Indebtedness is extended and compounded when the automatic payment cannot be honoured because of a lack of funds, and commonly a $25 default fee is charged by banks.

In 2008, the Ministry of Consumer Affairs used training sessions with Budget Advisory Services and Citizens Advice Bureaux as an opportunity to test whether mobile trucks were still causing problems. With the exception of one Bureau, all agreed that they were a problem. The main concerns raised were that:

- After direct debits were stopped by banks, another was simply submitted (pre-signed by the borrower).
- Trucks were not providing proper disclosure under the CCCFA.
- Trucks were refusing to refund credit accumulated in an account as a result of automatic payments with no accompanying purchase activity.
- Mental health patients were targeted.
- Cancellation fees were being charged.
- Security was being taken.

The Ministry of Consumer Affairs considers that while mobile shops and clothing trucks are selling goods, in fact they fall into the category of fringe lenders. The Commerce Commission treats them as such, and in 2007 formally warned four clothing truck companies that they were not making adequate disclosure under the CCCFA.

Other lending practices

Certain undesirable lending practices also appear to be more common to fringe lending. Some of these practices have been found to be a breach of the CCCFA and Fair Trading Act 1986 as noted in the case example below. Observed practices include:

- Misrepresentation of consumer rights or the nature of the contract (including contracts in English when the person signing does not have a good understanding of English).
- Small print and not given time to consider the contract before signing.
- Selling of unnecessary insurances (e.g. unemployment insurance to a beneficiary).
- "Free money" deals. Buy a vehicle; get a $1,000 cash back (which is simply added to the cost of the loan).
- Extraordinary fees, such as the $80 cost of a reminder to pay notice.
- Withholding family heirlooms provided as security (e.g. tapa mats withheld from borrower just prior to a wedding).
- Holding of eftpos cards and passports as "security".
- Disclosing debt information to other parties such as church elders, family members. Such disclosure normally is a breach of the Privacy Act but a condition of the loan will be to agree to waiver Privacy Act requirements.
- Publication of the borrower's photo in local newspaper as being a loan defaulter. These are used as a threat or as a means to embarrass borrowers into repaying.
- Threatening action e.g. taking of essential items such as children's beds, toys, and household items such as ovens as a means to coerce payment. (The Ministry of Consumer Affairs recently learnt of a repossession where everything from a private secured storage facility was taken, including children's paintings.)

Case Example

A court case heard in March 2008 against a finance company in South Auckland exemplifies some of the behaviours involved.

Between 1 June and 30 November 2006, the finance company failed to provide initial disclosure (required under the CCCFA) in 616 consumer credit contracts. The contracts provided to debtors did not include the required information about: what the annual interest rate was; how interest was calculated; the debtor's right to repay early; and the debtor's right to cancel the contract within three days.

The company also made false and misleading representations it sent regarding its right to enforce the contracts in default letters and sold security items held for 27 contracts when in fact the credit contracts could not be enforced as correct disclosure had not been made. The company also published photographs and personal details of at least four debtors in a local Tongan newspaper claiming that these debtors had defaulted on loans that were in fact unenforceable.

A notable incident occurred where immediately prior to a wedding, the company withheld tapa clothes being held as security from the family and required payments in excess of the value of the loan before they would be released.

The finance company pleaded guilty to 18 breaches of the CCCFA and two breaches of the Fair Trading Act following an investigation by the Commerce Commission. The Court ordered a refund of $12,520 to affected debtors.

10. Mitigating the Practices of Fringe Lending

As noted in the 2007 report *Pacific Consumers' Behaviour and Experience in Credit Markets*, many people are accessing fringe credit because they cannot access other credit or are unsure how to access other credit or are uncomfortable accessing other credit. In the main people obtaining credit from fringe providers are managing to pay it back, but are doing so at a high cost. As a result they will have less income for use on other goods.

The concern with the fringe practices noted is that the marketing strategies engaged in by such lenders entice some individuals into taking on excessive debt or becoming dependent on debt, with significant implications for the individuals concerned and their families. The lenders take advantage of low levels of financial literacy and other factors that contribute to poor decision-making, and thus can be said to exploit these individuals.

A range of options for addressing the problems have been identified. These have been assessed against the status quo, as an option is to rely on the law as it stands and non-regulatory measures such as financial education and advice, rather than introducing new laws and policies.

The status quo needs to take into account policy changes that are already in train and are expected to address the problem, as well as other proposals that are contained in this discussion paper. The following table summarises the various approaches that could be taken. Options 1, 4, 5 and 6 have been discussed elsewhere in this paper. The other options are discussed in this section.

Problem identified	**Option**	**Status**
Consumers in difficulty due to unforeseen hardship and not able to access the hardship provisions	1. Borrowers may apply for unforeseen hardship relief in default.	Proposed
Consumer access to low cost redress	2. Disputes Tribunal hearing limit increases will mean greater ability to access redress.	Implemented
Consumer access to low cost redress	3. Compulsory membership of dispute resolution scheme. The disputes resolution service will be able to look at a complaint to see that the complainant has been treated fairly. Should result in a reduction of unfair lending practices occurring.	Currently being implemented. All credit providers will need to be registered and belong to a dispute resolution service by late 2010.
Indebtedness related to unsolicited credit	4. Opt-in provisions for credit cards and credit limit increases would mean consumers will have to make a conscious decision about extending credit.	Proposed
Indebtedness related to low financial literacy	5. Greater disclosure on the implications of just paying the minimum payment on credit cards would mean consumers will	Proposed

Problem identified	Option	Status
	more clearly see what paying only the minimum repayments will mean.	
Unfair Repossession	6. Clear disclosure about the items that are being agreed as security for a loan should mean consumers will not be able to be "bullied" by repossession of essential household items unless a conscious decision has been made to allow such items to be used as security.	Proposed
Unfair contract terms	7. Prohibition of unfair contract terms - if a particular term in a standard form contract is found to be unfair it can be made void by the Courts. This may address some undesirable fringe lending conditions of credit contracts.	Under consideration as part of consumer law review
Over indebtednesses and credit being given to a consumer who is unlikely to be able to repay the credit	8. Responsible lending requirements and positive licensing are being considered in Australia as one means of addressing over indebtedness.	Not proposed but monitor Australian reforms
High interest rates	9. Interest rate caps - are argued as a way of stopping very high interest rates.	Not proposed

Disputes Tribunal hearing limit increases

A Disputes Tribunal operates as a low-cost and effective means to resolve consumer to business disputes, business to business disputes, or person to person disputes (e.g. neighbouring fence issues). Under the Disputes Tribunal Act 1988, referees are able to consider the merits of a case in reaching a decision. They are not obliged to follow the letter of the law if doing so would result in a perverse or unjust outcome.

The level at which a Disputes Tribunal can hear cases has recently been raised to $15,000, or if both parties to the dispute agree, to $20,000.

The higher Disputes Tribunal limits will allow more consumers who are having problems with credit contracts and fringe lender behaviour, to seek redress through a Disputes Tribunal.

Compulsory membership of approved dispute resolution scheme

The Financial Service Providers (Registration and Dispute Resolution) Act 2008, which is currently being implemented, requires all financial service providers to be registered. Fringe lenders are financial service providers, along with banks, mortgage brokers, currency exchangers, insurance companies and many others. As a condition of registration, all financial service providers must be members of an approved dispute resolution scheme or the reserve (dispute resolution) scheme if they provide services to the public. Through the disputes resolution service, lenders are to be held accountable to codes of practice established under the scheme, and consumers will have access to a means of redress.

Discussion papers on the proposed rules for the reserve scheme and guidance on becoming an approved dispute resolution scheme have been released. It is anticipated that the requirements of the Act will be operative in late 2010, at which time all lenders must be members of a scheme.

Access to dispute resolution schemes is available when a consumer has a dispute about fairness, breach of industry codes and statutory duties. This will not help the consumer where the problem is one of general indebtedness, and the lender has not acted in an illegal manner or against the code of practice. As such, dispute resolution is not a mechanism which will prevent consumers from getting into debt and having their property repossessed in the short run.

However, it is expected that in the long run compulsory membership of a dispute resolution scheme will have a positive effect on the practices of fringe lenders and other financial service providers. This is due to disputes rulings, educational programmes and accountability requirements established by the schemes.

It is expected that fringe lenders will modify their practices in response to dispute resolution scheme rulings. A ruling may also direct that a fringe lender subject to a complaint amend certain lending practices. Dispute resolution schemes will be encouraged to publish rulings in a summarised and anonymous form. This will help inform lenders on what is acceptable practice, and will educate consumers on their rights in relation to credit transactions.

The schemes will also have an obligation to report systemic issues within the industry. Annual reports to the Minister of Consumer Affairs should also highlight such issues. This should lead to greater detection of industry-wide consumer issues. This will inform enforcement action and future policy development.

Licensing and responsible lending obligations

Australia has recently adopted a new policy for the regulation of credit provision. The policy includes:

- a national licensing regime regulating credit providers and providers of credit related services enforced by the Australian Securities Investments Commission (ASIC); and
- responsible lending conduct obligations. The obligations aim to ensure "that licensees do not provide or suggest unsuitable credit to a consumer. To meet these obligations, licensees will have to make an assessment to ensure that any credit contract meets the consumer's requirements; and that they have the capacity to repay the financial obligations".

The following table compares the current CCCFA regime alongside the regime that is being introduced by the Financial Service Providers (Registration and Dispute Resolution) Act, and the Australian credit law reform proposals.

	CCCFA Regime	**Financial Service Providers Act 2008 regime to apply from mid 2010**	**Australian Credit Policy law reform package**
Registration	Nil	Mandatory	Mandatory
Licensing	Nil, but person can be prevented from operating under the CCCFA	As part of registration, all lenders have to meet certain criteria (referred to as negative licensing)	Positive licensing i.e. fit and proper person to be a lender, and they meet the legal obligations of a

	CCCFA Regime	Financial Service Providers Act 2008 regime to apply from mid 2010	Australian Credit Policy law reform package
			licence holder (such as acting honestly, efficiently and fairly)
Obligations	Compliance with the CCCFA	Must belong to Disputes Resolution Scheme (DRS) and abide by decisions of DRS	Abide by the National Consumer Credit Protection Act's general conduct obligations including responsible lending obligations. Abide by DRS orders. Be a member of an ASIC-approved External Dispute Resolution scheme.
Consequences	Comply with Disputes Tribunal or other Court orders or Commerce Commission sanctions	Refusal to comply with DRS orders may result in registration being cancelled and inability to trade	Breaches of licensee obligations may result in suspension or cancellation of licence to engage in credit activities.
Regulator	Commerce Commission	Securities Commission	ASIC

The proposed Australian regime would address the issues that have been identified with fringe lenders. The credit regime replaces Australia's State-based consumer laws which operate inconsistently across the eight jurisdictions, with a single, nationally consistent regulation of consumer credit. Costs are expected but are offset by the benefits to industry and consumers. Given the range of other initiatives being undertaken or proposed in New Zealand, including the regime being introduced by the Financial Service Providers (Registration and Dispute Resolution) Act, a further initiative along the Australian lines is not considered necessary at this stage. The proposed Australian regime does, however, provide us with the opportunity to monitor an innovative approach, and will provide policy insights over time.

Interest rate controls

A commonly suggested response to what may be perceived as high interest rates for credit is the introduction of interest rate controls or caps that limit the level of profit that lenders can make from borrowers.

Those in favour of interest rate controls point out that excessively high interest rates tend to affect the most vulnerable and disadvantaged in the community, worsening their financial position. Interest rate controls have been introduced in some countries predicated on the assumption that this will ensure borrowers pay fair rates for credit and will be protected from fringe lenders who price their lending to make excessive or exploitative profits.

Price controls are seen as a way of rebalancing the bargaining power between borrowers and lenders. People who seek money from fringe lenders are often in a position of desperation for finance with minimal avenues to get that finance. Accordingly, there is little room for negotiation as the lender recognises the position the consumer is in. The inference is that the introduction of a cap reduces this inequity.

The argument against the interest rate controls is the potential for credit exclusion and credit shortage in the segment of the market they are attempting to protect. This unintended consequence was identified in a 2004 paper by the United Kingdom's Department of Trade and Industry (DTI), which surveyed the effect of interest rate ceilings in a number of countries.

Arguments for allowing flexible interest rates include:

- Interest rate caps impose a ceiling on the cost of credit.
- A limit set too high can result in that limit being a price goal for lenders thereby increasing the overall cost of credit to users of fringe services.
- A limit set too low reduces the availability of credit sources, potentially channelling borrowers to inappropriate credit products.
- If a cap is introduced at a level insufficient to generate a lender's required margin, the price of credit can be transferred from the interest rate into fees and other charges thereby negating the intention of the price control.
- A flexible price model means that lenders will less likely be tempted to operate in the black market.
- A price cap might signal to consumers that the government has determined the rate is "safe" for the consumer to enter into. This will not necessarily be the case given the variability of conditions and circumstances in which consumers find themselves.

Generally speaking, the arguments related to interest rate caps are that they restrict product diversity and where lenders cannot accommodate the price cap within their business structure, the effect is credit exclusion for consumers from the services of fringe lenders.

After evaluation of overseas experiences which appear to confirm the arguments for not introducing interest rate caps, the Ministry of Consumer Affairs does not support such a policy. However, there is an ongoing debate regarding the effectiveness of interest rate caps and the Ministry will continue to monitor this subject area.

Q.17

Part 2 of the Discussion Paper has highlighted concerns that have been raised in relation to fringe lending practices and noted various initiatives that are underway, or proposed that should have a deterrent effect on undesirable fringe lending practices. Your views are sought on:

- The regulatory initiatives proposed and whether you think these will help address fringe lending practices; and
- Other suggestions for addressing fringe lending practices.

List of Questions

Q.1

- Do you agree that amending the CCCFA to provide that when purchasing a motor vehicle from a motor vehicle trader (as defined in the Motor Vehicle Sales Act 2003), and accessing credit at the time of the purchase, the borrower must be provided with the disclosure as required by the CCCFA immediately at the time of sale would reduce problems associated with motor vehicle finance?
- What advantages or disadvantages do you see the above proposed amendment to the CCCFA provides to consumers and traders?
- Are there other options to address the issue?

Q.2

- Is it reasonable to require insurance disclosure in accordance with sections 32, 33 and 35 of the CCCFA?

Q.3

- What are your views on increasing the disclosure required for prepayment fees? Is your preference for an "alert", for example, a matrix of possible scenarios, or detailed estimates?
- Will disclosing full information on potential break fees across various timelines and a range of differing interest rates provide a more useful basis than an "alert" on which to inform the lending decision?
- Will provision of such information crowd out other relevant disclosure information?

Q.4

- Should credit card issuers be required to provide disclosure regarding the true cost of interest that accrues when minimum payments are made?

Q.5

- Do you agree that the proposal allowing compliance with the requirements of section 59 of the SDPA to meet the CCCFA disclosure requirements of section 17, and exempting pawnbroking from the continuing disclosure and prepayment requirements of the CCCFA, would reduce problems associated with the clashes between the SDPA and CCCFA for pawnbroking credit transactions?
- What advantages or disadvantages do you see the above proposal provides to consumers and traders?
- Are there other options to address the issue?

Q.6

- Do you think the provision of fee guidelines will provide sufficient advice for industry to develop their fee structures?
- Does there need to be more regulation or prescriptive guidelines for fees; if yes, in what areas?

Q.7

- Should the CCCFA prevent fees for future services from being frontloaded into the start of the credit contract?

Q. 8

- Is there a need to change the timeframe under section 41 of the CCCFA for applications to annul or reduce a fee?

Q.9

- Should the CCCFA be amended to provide that fees or charges may only be passed on by a creditor if from an arm's length third party?

Q.10

- Do you agree that hardship applications should be able to be made when in default? Is the 2 month timeframe appropriate?

Q.11

- Will the proposed changes to the hardship provisions improve the effectiveness of the hardship provisions?
- Are the acknowledgement and processing timeframes proposed realistic and appropriate?
- Do you think failure of a lender to meet their obligations should result in the Disputes Tribunal being able to make any order it sees fit under the hardship provisions?
- By what means should an application for hardship be recognised? Should it have to be in a written form – letter or email – or should allowance be made for verbal applications?
- Should a lender have to provide the reasons for declining a hardship application?

Q.12

- Do you agree that hardship application fees should not be permitted?
- Should refinancing fees not be permitted when a consumer is in a situation of unforeseen financial hardship?

Q.13

- Do you support the addition of information in the credit contract disclosure about hardship applications?

Q.14

- Do you agree that credit and finance card limit increases should be opt-in only?
- Should there be a timeframe from when the credit is first arranged to when the lender can make an approach with a limit increase?

Q.15

- Should there be more specific disclosure of personal property that may be taken as security by a creditor if a debtor is in default in the credit contract?
- Should the Credit (Repossession) Act provide that personal property cannot be seized unless it has been sufficiently described in the security agreement?

Q.16

- Does there need to be enforcement of compliance with the Credit (Repossession) Act by an agency such as the Commerce Commission?
- Is there the right balance between creditor and debtor rights in the Credit (Repossession) Act?
- Should a creditor be required to seek an order from an independent authority or warranted officer before commencing a repossession?
- Do there need to be more penalties to ensure compliance with the Credit (Repossession) Act entry onto premises and repossession notice provisions?

Q.17

Part 2 of the Discussion Paper has highlighted concerns that have been raised in relation to fringe lending practices and noted various initiatives that are underway, or proposed that should have a deterrent effect on undesirable fringe lending practices. Your views are sought on:

- The regulatory initiatives proposed and whether you think these will help address fringe lending practices; and
- Other suggestions for addressing fringe lending practices.

References

'Pacific Consumers' Behaviour and Experience in Credit Markets, with Particular Reference to the 'Fringe Lender Market – Research and Findings Report and Government's Response Strategy' Ministry of Consumer Affairs, August 2007
http://www.consumeraffairs.govt.nz/policylawresearch/research/pacific-consumers/report/index.html

'Fringe Lenders in New Zealand: Desk Research Project' Ministry of Consumer Affairs, July 2006
http://www.consumeraffairs.govt.nz/policylawresearch/research/fringe-lenders/report/fringe-lenders-report.pdf

'Report to the Māori Affairs Committee on Fringe Lending and Māori' Ministry of Consumer Affairs, May 2009

'High Cost Loans: A Case for Setting Maximum Rates?' CCCL Background Paper Griffith University Centre for Credit and Consumer Law, August 2005

'The effect of interest rate controls in other countries'. Department of Trade and Industry, United Kingdom, August 2004

Commerce Commission v Avanti Finance Limited DC AK CRI -2007-004-010204 [10 June 2008]

Commerce Commission v Avanti Finance HC AK CRI-2008-404-210 [28 April 2009]