19 June 2024

Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
Wellington 6140

Submission on fit for purpose consumer credit legislation

Introduction

1 This is Anthony Harper's submission on the Ministry of Business, Innovation & Employment's consultation on fit for purpose consumer credit legislation.

2 Anthony Harper is a large New Zealand law firm, with over 30 partners and around 150 people operating out of our offices in Auckland and Christchurch. Anthony Harper has recognised expertise in a large number of practice areas, including in financial services and banking law where are partners are ranked as among the best in the country.

Submission

3 We support a move to a more risk-based approach to the regulation of consumer credit, including most of the preferred options set out in the discussion document. We are particularly encouraged by potential changes to the director and senior manager due diligence duty and personal liability settings and to section 99(1A), and we support the preferred option for licensing.

4 Our full submission is attached.

Further information

5 I would be pleased to discuss any aspect of this submission. I can be contacted on 09 984 4234 or at nick.summerfield@ah.co.nz.

6 Thank you for the opportunity to submit.

Yours faithfully
Anthony Harper

Privacy of natural persons

Nick Summerfield
Partner

Contact: Nick Summerfield +64 9 984 4234 nick.summerfield@ah.co.nz
Our reference: 035138-23-7748540-2

Submission on discussion document: *Fit for purpose consumer credit legislation*

Your name and organisation

Name	Nick Summerfield and Lucy Scott
Organisation (if applicable)	Anthony Harper
Contact details	nick.summerfield@ah.co.nz; lucy.scott@ah.co.nz

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Responses to discussion document questions

	1. Options to amend the CCCFA to enable the FMA to carry out its role effectively **A. Options for liability settings**
1	*Do you have any evidence or experience of the due diligence duty and personal liability resulting in overly conservative approaches to complying with the CCCFA? What impact did this have on consumers? How common do you think this is?*
	We act as legal advisers to lenders operating across the sector. In our experience, the due diligence duty and personal liability settings have led to a more conservative approach to complying with the CCCFA than might have otherwise been the case. The due diligence duty and personal liability settings have also contributed to decisions by some lenders to cease offering some types of credit products and/or to focus solely on non-consumer credit. In our view, these have been common and sensible commercial responses to the regulatory environment. We do not have direct experience of the consumer impact of these consequences. However, we expect they will have reduced the availability of credit, potentially increased the cost of credit, and/or made the process of seeking credit more burdensome than might otherwise have been the case.
2	*Do you have any observations about how the impact of the due diligence duty and personal liability works may or may not depend on the size of the lender?*
	In our experience, all directors and senior managers are concerned about the impact of the due diligence duty and personal liability. However, the way they respond tends to differ. Larger lenders are inherently more complex, and the directors and senior managers of those organisations are less involved in day-to-day lending activities, such that their concerns tend to be reflected in the organisation's systems and procedures. In smaller lenders, with greater director and senior manager involvement in lending activities, this concern manifests itself in other ways. For example, we have seen these concerns reflected in decisions to cease consumer credit altogether, and anecdotally we understand it has influenced individual lending decisions made by smaller lenders.
3	*Are you aware of any other problems with these liability settings?*
	We are not aware of any other problems with these liability settings. However, we note that other aspects of the CCCFA have also contributed to more conservative approaches to consumer credit than might have otherwise been the case. We support all changes to adopt a more risk-based approach to consumer credit.
Option A1: Retain the due diligence duty but remove restrictions on indemnities and insurance (preferred)	
4	*If lenders were able to indemnify their directors and senior managers from liability for pecuniary penalties (and costs), what difference (if any) would you expect that to make to how those individuals and the company as a whole approach the due diligence duty?*

	We believe the ability for lenders to indemnify directors and senior managers in respect of the due diligence duty would provide a degree of comfort to directors and senior managers and, together with other changes proposed, would improve the current regulatory settings. However, while we support this change, it is unlikely to have a meaningful impact in isolation. As the discussion document says, this change would merely shift the potential exposure from directors and senior managers to the lender, rather than removing it.
5	*If insurance were available for pecuniary penalties liability, what difference (if any) would you expect that to make to how directors and senior managers and the company as a whole meet their due diligence duty? Do you have any information about how affordable that insurance might be for different types of lenders?*
	Similar to our comments above, while the proposal to remove the restriction on insurance would improve the current regulatory settings (and is therefore something we support) it is unlikely to have a meaningful impact in isolation. As stated in the discussion document, insurance is likely to redistribute a lender's cost rather than reducing it. We do not have any information as to the cost (or availability) of insurance for different types of lenders.
Option A2: Remove due diligence duty for licenced lenders	
6	*Do you agree that the due diligence duty is less likely to be needed for lenders who are sophisticated enough to be licensed under the CoFI Act? Why/Why not?*
	We agree that CoFI obligations require good governance and a degree of sophistication in processes and controls, and therefore understand the argument that the due diligence duty may be less likely to be needed for licensed lenders. However, when considered in the context of CCCFA duties, we are not convinced that the distinction between CoFI licensing and the current fit and proper certification regime is so great that it warrants a different treatment for licensed lenders. On the assumption that MBIE's preferred option for credit licensing (which we also support) is adopted, this is merely a timing issue – as in due course all consumer lenders would be licensed, and would therefore benefit from a removal of the duty for licensed lenders.
7	*How well do you think licensing and ongoing supervision by the FMA could replace the need for due diligence and personal liability? Does this depend on the kind of lender? If so, how?*
	A licensing regime with ongoing FMA oversight would, in our view, be sufficient to remove the need for due diligence and personal liability under the CCCFA. We do not believe this would depend on the type of lender. If the FMA had concerns about a particular lender, or particular class of lenders, they would be able to respond in line with their usual risk-based approach to ongoing supervision.
8	*What impacts might options A1 and A2 have on lenders and consumers compared to the status quo? For lenders, how would you expect lender decision-making and compliance cultures to change under these options?*

	Both options A1 and A2 would improve the status quo, and we recommend both options are adopted. We do not support option A3 (retention of the status quo). We would expect options A1 and A2 together to contribute to lenders taking a more pragmatic approach to lending decisions and compliance practices. However, for the full benefit to be realised, it is important to address all of the issues with the current regulatory settings (including those that we comment on elsewhere in this submission, such as the penalties for incomplete disclosure).
	B. Options for regulatory model
9	*Do you agree that these are a fair reflection of the minimum legislative changes that are required to transition credit to the FMA? If not, please explain*
	We agree the matters outlined in the discussion paper are a fair reflection of the minimum legislative changes that are required to transition credit to the FMA. However, we would look to give this further consideration as part of consultation feedback on an exposure draft of the necessarily legislation, or similar.
Option B1: Transition to a market services licence and apply all FMA core and licencing powers to consumer credit (preferred)	
10	*What implications would you expect from adopting a licencing approach and the associated regulatory tools for credit?*
	We support option B1. Moving to a licensing regime for consumer credit as part of the transition from the Commerce Commission to the FMA makes sense as there is no compelling reason to treat consumer credit differently from other market services regulated by the FMA. This option means consistency across the universe of entities licensed by the FMA, and aligns with the single conduct licensing proposal outlined in the fit for purpose financial services conduct regulation discussion document. However, licensing would be a step up from the current certification regime, both in terms of the likely regulatory scrutiny before granting a licence, and in ongoing oversight. It would be a significant change for existing certified lenders, particularly those who do not otherwise have any interaction with the FMA. It would impose additional cost for certified lenders, and we agree that some may choose to exit the market (either entirely, or by focussing on non-consumer credit). As the discussion document notes, this could reduce competition and diversity of choice. However, we expect this would be at the margins.
11	*What modifications to the FMA's existing regulatory tools, such as stop orders, should we consider if extending them to the CCCFA under this option?*
	Our current view is that no modifications to the FMA's existing regulatory tools would be needed. Conceptually, we see no compelling reason to treat consumer credit differently from other market services regulated by the FMA. However, this is a point we would look to give further consideration as part of consultation feedback on an exposure draft of the necessarily legislation, or similar.

12	*What do you think about the transitional licence approach, including what time periods are appropriate?*
	We agree that transitional arrangements are needed, and we support the proposed transitional licence approach outlined in paragraphs 39 and 40 of the discussion document. We suggest a transitional period of two years from commencement of the relevant legislation would be appropriate. This is in line with the transitional approach adopted for financial advice provider licensing (which we see as broadly comparable) and reflects the significant work that will need to be undertaken by certified lenders.
Option B2: Retain 'Fit and proper' certification (status quo) and add FMA core tools for enforcing the regulatory perimeter	
13	*Do you agree with our analysis about the relative benefits and risks of the certification model? Why/ why not?*
	We agree with MBIE's analysis of the relative benefits and risks of the certification model. However, as noted above we support option B1. We see no compelling reason to treat consumer credit differently from other market services regulated by the FMA.
14	*Are there additional tools that you consider the FMA should have to regulate credit, for examples tools like action plans or censures that are usually only available under a licensing model?*
	We have no comments on this question, on the basis that we do not support option B2. We support option B1 and, as part of that, the availability of the full FMA regulatory toolkit for consumer credit.
	2. Options to amend disclosure requirements
	C. Options for what and when information must be disclosed
15	*As a consumer, do you receive the right kind and amount of information to make informed decisions? Why/why not?*
	While we submit as lawyers and not as consumer advocates, we agree with the sentiment that the nature and volume of information that is disclosed (and the repetitive nature of some disclosure requirements) can be overwhelming. We support a more targeted approach to disclosure, contingent upon the reforms providing sufficient regulatory certainty for lenders, to minimise the cost burden of any change to the disclosure requirements.
16	*Do you consider any of the disclosure obligations to be irrelevant, confusing, or inappropriate? If so, please tell us what obligations you are referring to and what impact this has.*
	We agree that the obligation to make disclosure about debt collection (s 132A) is unclear and confusing. For example, the broad definition of debt collector can capture lawyers acting for a lender, requiring repetitive disclosure by both the lender and any lawyer acting for them in relation

	to the same credit contract. This is duplicative, burdensome and can cause confusion among borrowers. The exception for creditors that have complied with section 119 of the Property Law Act 2007 (s 132A(5)(b)) is ambiguous and can lead to different practices between lenders. It makes sense to interpret this exception to apply in scenarios where a creditor intends to comply with section 119 of the Property Law Act 2007. This should be clarified in the legislation. Beyond these specific comments, we believe there is a need for a wider review of the detail of disclosure requirements to ensure they are fit for purpose, do not impose unnecessary cost, and do not result in disclosure that is irrelevant, confusing, or inappropriate. For example, the obligation to provide continuing disclosure can be considered superfluous in circumstances where the customer has entered into a fixed rate, fixed term consumer credit contract. There may be a need for further consultation on this point.
17	*How could disclosure obligations be more targeted to the consumer's circumstances to ensure only relevant information is disclosed?*
	We believe there is a need for a wider review of the detail of disclosure requirements so that disclosures are more targeted to the consumer's circumstances and only include relevant information. However, commenting on the specific matters that should be disclosed is beyond our expertise as lawyers typically acting for lenders.
18	*Is the information set out in Regulations 4F and 4G both sufficient and do sections 22 and/or 23 require the right information to be disclosed when a contract is varied?*
	We do not offer a view on whether the information set out in regulations 4F and 4G is the *right* information to be disclosed. However we agree that the drafting of sections 22 and 23 should be amended so it is clear that the information set out in the regulations is the only information required to be disclosed, and not additional disclosure requirements.
19	*Are there any other concerns or issues you would like to raise related to disclosure obligations?*
	We agree that the role of disclosure as a form of consumer protection has been diluted somewhat by the creation of lender responsibility principles. The cost of complying with disclosure obligations can be disproportionate to the benefit to consumers, particularly given the potentially draconian consequences of a failure to provide timely and complete disclosure (see our comments on this point later in this submission). In addition, over-provision of information can defeat the purpose of disclosure requirements by overwhelming customers. As mentioned above, we believe there is a need for a wider review of the detail of disclosure requirements to ensure they are fit for purpose, do not impose unnecessary cost, and do not result in disclosure that is irrelevant, confusing, or inappropriate.
	D. Options for how information must be disclosed

20	*As a lender, do you identify any barriers in the Act to the use of electronic methods of disclosure? If so, can you explain what are these barriers and how they impact your processes?*
	The requirement to obtain customer consent for electronic methods of disclosure is an impediment to this method of disclosure. From a systems perspective, maintaining a record of customers that have consented to electronic disclosure, and running dual processes for disclosure depending on whether a customer has provided consent, is complex and creates risks that steer lenders towards a singular default method of (paper/postal) disclosure.
21	*As a lender, are there any practical difficulties with obtaining the borrower's consent for electronic forms of disclosure (section 32(4)(b))?*
	Based on our discussions with lenders, there are practical difficulties associated with: (a) Confirming and maintaining a record of positive consent to electronic forms of disclosure, noting this can be done through on-boarding and lending documentation. (b) Running separate processes for customers that require paper disclosure compared to electronic disclosure.
22	*What would be the implications of removing the requirement to obtain borrower's consent for electronic communication and forms of disclosure (section 32(4)(b))?*
	We believe it would be preferable to have electronic communication as the default method of disclosure for customers that have provided an email address. We acknowledge that certain customers prefer traditional paper disclosure (if they are unfamiliar with, or have issues accessing, electronic communication). Those customers could be dealt with by exception, together with customers who do not or cannot supply an email address when entering into a consumer credit contract.
	E. Options for penalties for incomplete disclosures by lenders
23	*Do sections 95A and 95B meet their objectives? Why/why not?*
	We agree with the intention behind sections 95A and 95B, being to ameliorate the potentially disproportionate consequences of erroneous initial or variation disclosure. However, there are some issues with the approach: • Lenders are required to apply to Court for an order to reduce the effect of a failure to make disclosure. An order can only be granted in respect of a "class of consumer credit contracts", rather than individual borrowers. This adds significant cost and uncertainty for lenders (discussed further below), in circumstances where a non-material error has been made and the breach covers a significant time period and/or number of customers. • Further, the application of sections 95A and 95B is largely untested, and there is considerable uncertainty about how those sections might apply to different fact scenarios. Any order is discretionary, and the Court must weigh the competing objectives of incentives for compliance with the CCCFA (s 95B(a)) and the extent to which any person has been prejudiced by the breach (s 95B(d)), among other factors.

The competing arguments in the banking class action proceeding against ASB and ANZ (*Simons v ANZ Bank NZ Ltd* [2022] NZHC 1836) is evidence of this uncertainty.

- Sections 95A and 95B only apply to breaches that occurred on or after December 2019. This gives rise to potentially significant residual exposure for lenders for breaches that occurred prior to this date. The Discussion Paper released by MBIE in November 2016 considered making any amendment retrospective, but ultimately Parliament did not elect this option. In our view, any legislative change should apply retrospectively to 6 June 2015 (the date that section 99(1A) came into effect).

Overall, we consider that sections 95A and 95B do not fully meet their objectives. The uncertainty (and cost) involved in obtaining a court order, combined with unmitigated exposure for breaches during the period June 2015 to December 2019, creates a considerable risk that non-material breaches may have disproportionate consequences.

24 *As a lender, to what extent does section 99(1A) impact the time, effort, and costs you dedicate to initial and variation disclosures?*

Based on our experience acting for lenders, significant time and investment is dedicated to compliance with initial and variation disclosure obligations. This necessarily differs depending on the scale of the lender, but in our experience all lenders wish to comply with their disclosure obligations and make a significant effort to do so.

Larger lenders, who have more customers and generally higher loan values, are particularly exposed to this issue as a small but insignificant error could have disproportionate consequences multiplied across a large customer base. However, the impact can also be significant for smaller lenders.

There is a legitimate concern that the time and effort spent on compliance in this area does not have a proportionate benefit to customers.

The importance of compliance with initial and variation disclosure requirements is highlighted by the potentially draconian consequences of section 99(1A), but it is not the only factor, as there are a range of potential sanctions for non-compliance with disclosure requirements.

25 *Under option E1, what should a materiality test look like?*

As suggested in the discussion paper, a materiality test could be formulated with reference to section 32(1)(d). Section 99(1A) could be amended to read:

"Neither the debtor nor any other person is liable for the costs of borrowing in relation to any period during which the creditor has failed to comply with section 17 or 22, *<u>where the failure to comply was likely to deceive or mislead a reasonable person with regard to any particular that is material to the consumer credit contract</u>*."

26 *Under option E1, which party should have the burden of proof and what would this mean for the effectiveness of the option? If the onus is on borrowers to show materiality would that deter them from seeking redress under section 99(1A)?*

This question is finely balanced. There are good reasons for placing the burden on lenders to prove that the failure was not likely to mislead or deceive a reasonable person with regard to any material particular.

	The lender is responsible for complying with the CCCFA, and perhaps logically should be tasked with showing that any failure is not material, such that the draconian consequences of section 99(1A) should be avoided. However, placing the burden on lenders carries the risk of continued disproportionate consequences, due to uncertainty around the boundaries of any materiality threshold. For this reason, we prefer a test that requires borrowers (or the FMA on their behalf) to face the burden of proof. We acknowledge the risk that any materiality threshold will be a disincentive to borrowers (or the regulator) using section 99(1A) to seek redress. Having said this, if the materiality threshold is carefully drafted, this risk is diminished. Other significant potential sanctions exist under the CCCFA, where the onus of seeking relief sits with the lender (most notable statutory damages under subpart 2 of part 4), such that lenders will continue to be incentivised to ensure compliance.
27	*Under option E2, how should the maximum amount the lender forfeits be calculated?*
	We have real concerns about a maximum limit on total liability under section 991A. We cannot conceive an equitable way to calculate a cap. Any maximum amount would not be connected to the nature and extent of the breach and may form a "starting point" for any compensation, irrespective of materiality or harm. A cap that is linked to a percentage of a lender's turnover could be inequitable for egregious breaches by smaller lenders. For these reasons, we do not consider that E2 is a feasible option.
28	*Under option E3, would there be the right incentives in place to ensure lenders comply with their disclosure obligations?*
	There is a good argument that the liability to pay statutory damages for disclosure breaches (and other penal consequences in the CCCFA), are likely to be sufficient deterrents for lenders. Section 99(1A) was enacted in 2014 in response to the *Norfolk Nominees Limited v King* case, where a lender did not make corrective initial disclosure until two and a half years after a loan contract was entered into. Upon making corrective disclosure, the lender successfully applied to recover all interest and fees for the prior two-and-a-half-year period. Section 99(1A) was enacted to correct this perceived injustice. There have been significant changes in the past decade, particularly following the joint RBNZ/FMA review of conduct and culture in banks (following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in Australia). Self-reporting and proactive remediation of breaches is more prevalent and is seen as part of the social licence for operating, particularly among larger lenders. This has been reinforced by the pending CoFI licensing regime, accepting that does not apply to all lenders. Assuming that the Commerce Commission (and subsequently the FMA) continue to oversee and enforce compliance where appropriate, we see a good argument that sections 99(1A) (and sections 95A and 95B) could be repealed.

	Payment of compensation by lenders to remediate disclosure errors is a significant factor in favour of a lower-level enforcement response (such as a warning letter). This is a relevant compliance incentive, coupled with the potential liability for statutory damages.
29	*What would be the risks associated with each option? How could they be mitigated?*
	Overall, while we understand why E1 is the preferred option, we are concerned that this option introduces further regulatory uncertainty regarding what is 'material'. There is no easy answer to the question of which party should face the burden of proving whether or not the failure meets a materiality test. On balance, we consider that this burden should sit with borrowers (or the FMA). While any materiality test would be objective, there is a wide spectrum of borrowers, and what may be misleading or material to an unsophisticated customer is less likely to mislead or be material to a more sophisticated customer. Cases under the CCCFA note a distinction between different types of borrowers based on their knowledge and experience - see *Mayes v Southern Cross Finance Ltd* [2014] NZHC 1164, where Andrews J compared the borrower in that case with the borrower in *Anderson v Burbery Finance Ltd* [1988] 2 NZLR 196 (CA), who was described by the Court of Appeal as an "experienced borrower". This demonstrates the difficulty of applying a universal materiality test across all customers, irrespective of their knowledge and experience. Incidentally, a materiality test may also lessen the likelihood of class action proceedings in this area, as lenders would argue that there is insufficient commonality among claimants if the breach must meet a materiality threshold. Even an objective test must be considered having regard to a reasonable person, standing in the shoes of the customer who did not receive fully compliant disclosure. A limit on total liability (E2) presents a number of issues regarding equitable calculation of a cap. It also does not address the risk in the current regulatory settings that some customers may receive a 'windfall' benefit from an inconsequential error in disclosure, irrespective of any harm. Ultimately, any payment to customers to refund the cost of borrowing is a cost to the lender, and such payments may flow through to higher prices for other customers. While a cap would ensure that disclosure errors do not threaten the existence or financial stability of lenders, it does not address the concern about 'right sizing' the consequence of such errors. Accordingly, this is our least preferred option (together with the status quo). The repeal of sections 99(1A), 95A and 95B (E3) is our second preferred option. This creates the most regulatory certainty, and is likely to reduce compliance costs compared to the other options. Changes in market practice and the potential for other regulatory interventions would, in our view, keep lenders in check. Retaining the status quo (E4) does not appear to be feasible. We agree it does not meet the Government's objective of reducing compliance costs while ensuring good customer outcomes.
	3. Review of the high-cost credit provisions
30	*What specific provisions (high-cost or other) have most impacted lenders' willingness or ability to offer high-cost consumer credit?*

	We do not have any comments on section 3 of the discussion document.
31	*In the absence of high-cost loans, what other avenues are borrowers turning to?*
	We do not have any comments on section 3 of the discussion document.
32	*Is the unavailability of high-cost consumer credit having positive or negative effects on would-be borrowers?*
	We do not have any comments on section 3 of the discussion document.
33	*What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 30 per cent to 49.9 per cent?*
	We do not have any comments on section 3 of the discussion document.
F. Options to amend the high-cost credit provisions	
Option F1: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 30 per cent	
34	*Are there any other issues associated with loans in the 30 per cent and 50 per cent interest rate range that we should be aware of?*
	We do not have any comments on section 3 of the discussion document.
35	*Are there examples where loans with interest rates between 30 per cent and 50 per cent would breach the 0.8 per cent rate of charge cap?*
	We do not have any comments on section 3 of the discussion document.
Option F2: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 45 per cent	
36	*What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 45 per cent to 49.9 per cent? Are there any other issues associated with loans in this interest rate range that we should be aware of?*
	We do not have any comments on section 3 of the discussion document.
37	*For lenders: If the government extended the high-cost provisions to loans with annual interest rate of 30 per cent or more, what would be the impact on your operations (if any)? Are there any changes to the high-cost provisions we should consider to enable those loans to remain profitable, and on what terms?*
	We do not have any comments on section 3 of the discussion document.
38	*How is a revised definition of a high-cost consumer credit contract interest rate threshold likely to affect access to credit for borrowers?*
	We do not have any comments on section 3 of the discussion document.

39	*Do you recommend considering another interest rate threshold? If yes, please explain why.*
	We do not have any comments on section 3 of the discussion document.
Option F3: Status quo	
40	*Do you have any other feedback on any of the high-cost credit provisions? Have they been effective in reducing financial harm caused by the excessive cost of credit for some types of loans and repeat borrowing by vulnerable consumers?*
	We do not have any comments on section 3 of the discussion document.
Option F4: Other high-cost provisions	
41	*Is there evidence of certain industry lending practices that are causing harm which the high-cost credit provisions could address?*
	We do not have any comments on section 3 of the discussion document.
42	*Are there any other industry lending practices that you believe are harmful to consumers?*
	We do not have any comments on section 3 of the discussion document.
43	*Do you agree with the suggested impacts of each of the identified options? Why/why not?*
	We do not have any comments on section 3 of the discussion document.
44	*Do you have any information or data that would support our assessment of the impacts of each of the options?*
	We do not have any comments on section 3 of the discussion document.
45	*Do you think that the CCCFA could be strengthened to protect consumers who are sold lending products or add-ons that exceed the value of the product? If so, how?*
	We do not have any comments on section 3 of the discussion document.
46	*Finally, are there any other areas and options for change that we should consider that have not been addressed in this discussion document?*
	We have no comments on this question.

Other comments

We have no other comments.