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Corporate Law
Labour and Commercial Environment Group
Ministry of Business, Innovation & Employment
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BY EMAIL: faareview@mbie.govt.nz

Re: Submission on Ministry Issues Paper – Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

1. This submission is made on behalf of the Exercise Association of New Zealand Incorporated, on behalf of exercise facility operators throughout New Zealand. It:

   - Addresses questions 64, 65, 66, 67 and 70 of the Issues Paper.
   - Raises serious concerns regarding the increased coverage of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act), caused by amendments to the definition of "credit contract" in the FSP Act, in that it now appears to apply to consumer services suppliers such as some exercise facilities which operate under long term consumer contracts.
   - Points out that this extension falls outside the Treasury's Principles for Best Practice Regulation.
   - Highlights the impacts of this on consumer service suppliers in terms of cost and time.
   - Points out the lack of benefit and indeed detriment to both suppliers and consumers if consumer service suppliers in general and exercise facilities in particular are put to the costs and uncertainties of joining a financial services dispute resolution scheme.

2. This situation has parallels with the situation that led to the exemption of various industries from the registration or dispute resolution provisions of the FSP Act under the Financial Service Providers (Exemptions) Regulations

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2010 and also the exemption of some non-financial services businesses from the application of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

3. Please would you address correspondence to me.

Yours sincerely

Rae Nield
Solicitor

Copy: Hon Paul Goldsmith, Minister of Commerce and Consumer Affairs
p.goldsmith@ministers.govt.nz

PART A: RESPONSE TO QUESTIONS

These responses are presented in the context of the issues raised in Part B, which explains how a minor statutory drafting change has led to a broadening of the coverage of the definition of “financial service provider” into non-financial areas.

Question 64 **Do you agree that the Register should seek to achieve the identified goals? If not, why not?**

Yes. The identified goals of usefulness, accuracy and accessibility are efficient and set out the boundaries for the requirement to register. Persons who fall within the statutory definition of “financial service provider” but do not fall within the goals should not be required to register. See paragraph 4 of Part B of this submission.

Question 65 **What goals do you consider should be more or less important in reviewing the operation of the Register?**

The requirement for usefulness should be paramount. If there is no clear reason for registration, persons should not be required to register. That usefulness should be considered in the light of other options available to consumers, for example, whether there are other cost-effective avenues for consumers to get the information they need (if indeed they need it) and whether registration imposes a burden upon businesses which has no counterbalancing benefit.

Question 66 **Do you agree that the dispute resolution regime should seek to achieve the identified goals? If not, why not?**

The Exercise Association notes and supports the goals of consumer awareness of, access to and confidence in dispute resolution, but suggests that this must be seen in the context of a specialist financial dispute resolution scheme which addresses only financial service issues that arise in connection with specialist financial services businesses.

Question 67 **What goals do you consider should be more or less important in reviewing the dispute resolution regime?**

The Exercise Association suggests that the goal of relevance should be added to enhance the effectiveness of the regime.

Question 70 **Does the requirement to belong to a dispute resolution scheme apply to the right types of financial service providers?**

The Exercise Association points out that because of the amendment to the definition of “credit contract” in the FSP Act, persons who provide non-financial services on a long-term basis can fall within the scope of the requirement to belong to a dispute resolution scheme. This would cause considerable transaction costs without benefit to consumers, and is detailed in Part B below.

PART B: THE NATURE OF THE PROBLEM

1. Summary

1.1. The problem addressed by this submission is that, because of minor drafting changes to the definition of “credit contract” in the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act), some service suppliers under long-term contracts that are not paid in full in advance by the consumer are required to register as financial service providers on the Financial Service Providers Register and to join dispute resolution schemes.

2. Analysis

2.1. The relevant amendment was to the definition of “credit contract” in s4 of the FSP Act. The amendment came into force on 1 June 2014. “Credit contract” under s4:

> *(a) has the meaning given by section 7 of the Credit Contracts and Consumer Finance Act 2003; but*
>
> *(b) does not include-*
>
>> *(i) contracts specified in section 15(1)(a) or (b) of that Act:*
>>
>> *(ii) [Repealed]*
>>
>> *(iii) contracts under which no interest charges, and no credit fees, as defined in section 5 of that Act are payable*

2.2. The relevant amendment was the addition of the words “and no credit fees” at paragraph (b)(iii) of the definition. That definition determines the meaning of “being a creditor under a credit contract” in s5(1)(e) of the FSP Act, being one type of “financial service” under the FSP Act.

2.3. The amendment to the s4 definition of “credit contract” was not included in the version of the Credit Contracts and Financial Services Law Reform Bill (Bill) that was available for public submissions and that was considered by the Commerce Select Committee. The amendment was introduced by the Select Committee in the second reading of the Bill.

2.4. The impact was to potentially cause some providers of goods and services under credit contracts, who are not financial services businesses, to be deemed to be providing “financial services” under the FSP Act. That reflects that, in some cases, the relevant agreements for sale or supply that provide for deferred payment, while not charging interest, may charge fees that could be seen to meet the definition of “credit fees” under the FSP Act.

2.5. The definition of “credit” is set out in section 6 of the Credit Contracts and Consumer Finance Act 2003 (CCCFA): “*In this Act, unless the context otherwise requires, credit is provided under a contract if a right is granted by a person to another person to –*

(a) *defer payment of a debt; or*

(b) *incur a debt and defer its payment; or*

(c) *purchase property or services and defer payment for that purchase (in whole or in part).*

It follows from this definition that agreements to sell goods and to supply services can be "credit contracts" under the CCCFA, where they provide for deferred payment terms and are not otherwise excluded or exempted from the application of the CCCFA.

2.6. The definition of "credit fees" is set out in s5 of the CCCFA as meaning *… 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, and*

(a) includes—

(i) establishment fees:

(ii) prepayment fees as defined in section 43(2) (whether in relation to part prepayments or full prepayments):

(iii) insurance premiums payable for credit-related insurance if the creditor requires the debtor to obtain insurance cover from a particular insurer or particular insurers:

(iv) fees and charges payable as referred to in section 45 if the other person, body, or agency referred to in that section is an associated person of the creditor; but

(b) does not include—

(i) interest charges:

(ii) charges for an optional service:

(iii) default fees:

(iv) government charges, duties, taxes, or levies:

(v) fees and charges payable as referred to in section 45 if the other person, body, or agency referred to in that section is not an associated person of the creditor

2.7. The definition of "credit fees" is therefore broad. There is a strong likelihood that fees charged under some contracts for service that provide for deferred payment could be considered to be "credit fees" even where the fees are included for reasonable and normal commercial purposes related to the supply of the service. On this basis, the supplier of long term services could be considered to be "a creditor under a credit contract".

3. Types of long-term services contracts

3.1. Using gym contracts as an example, several kinds of long-term contracts for services are offered to consumers:

(a) Member pays for full term in advance- not a credit contract as no services rendered before payment. This is relatively uncommon;

(b) Member is contracted to pay in regular instalments directly to the gym for the full term, and no interest charges apply - a credit contract but not a consumer credit contract as defined in the CCCFA. This is a very common type of contract and may provide for the payment of relevant charges that could be considered to come within the definition of “credit fees”.

(c) Member contracts directly with the gym for services and has a collateral contract including credit fees and potentially interest with a third party credit or payment services provider, who should in any case be registered as a financial services provider. The gym may also be a creditor under a credit contract, because the consumer has undertaken to the gym to pay the full amount over the term of the contract, but the true credit contract is with a third party.

3.2. The situations where the credit element of a service contract is provided by a third party credit provider is a direct parallel to purchasing goods on credit provided by a third party provider. However, it would appear that each of the third party credit provider and the service provider under a long term contract can be categorised as “being a creditor” under a credit contract, although the extent to which the service provider is caught is uncertain. It is likely to depend upon a variety of factors including the specific terms of the contract for services and the relationship between the service provider and the credit provider.

3.3. Each of the scenarios in paragraph 3.1(b) and 3.1(c) above can lead to the situation where the gym, a non-financial services business, is effectively within the definition of “financial service provider” under the FSP Act.

4. Policy issue

4.1. We understand that the concern that led to the amendment was that set out in the *Officials' Report to Commerce Committee* dated 30 January 2014, which states (at page 188) that "*The Bill does not address the exclusion [from the FSP Act] of creditors which do not charge interest but may charge credit fees under the definition of 'credit contract'. Payday lenders could readily take advantage of this exclusion, because they tend to charge fees rather than interest.*" This led to the recommendation at paragraph 57.2 of that Report *“… that credit contracts where credit fees but no interest are charged are not excluded under the FSP Act*.”

4.2. It is noted that report back from the Commerce Select Committee on the Bill which recommended this change to section 5(1)(e) shows that it was done for a very clear reason:

"The FSPA requires financial service providers (this includes persons providing credit under a credit contract) to be registered. One of the requirements for registration is for providers to become members of an approved dispute resolution scheme. We recommend amending section 5 (new clause 74A) to require persons who are creditors under a credit contract (rather than just those who only provide credit) to be registered. This would ensure that consumers had access to dispute resolution where debts had been on-sold, for example to a debt collection agency."

4.3. There is no argument that specialist financial service providers (including third party payment services and providers of credit under "interest free" loan agreements that charge credit fees) should be registered. However, disputes with non-financial service providers such as gyms will not be disputes relating to a finance business, and so will not require the specialist knowledge of a financial service dispute resolution scheme. Indeed, disputes will be typically of very low value, and if necessary can be addressed by an ordinary Disputes Tribunal. On the other hand, if a consumer is able to make a complaint to a Dispute Resolution Scheme as of right and at the gym's cost (and regardless of the value or merit of the dispute) this will become an expensive exercise for gyms caught under the FSP Act.

4.4. In contrast, it is noted that a supplier of **goods** under a credit contract provided by a third party will not be considered to be a "creditor" or to register as a financial service provider – indeed, that would defeat the purpose of the dispute resolution scheme. There would seem to be no reason for the suppliers of services to be similarly caught.

5. Further policy considerations

5.1. It is noted that the problems outlined above fall outside Treasury's Principles for Best Practice Regulation[1] and in particular the principle of proportionality. Treasury's "strong indicator of concern" threshold would appear to be met: *"Proportional Benefits grossly outweighed by administrative and compliance costs; risk not taken into consideration".* Indeed it is difficult to see any public or consumer benefit in gyms and other non-finance service providers being required to register as financial service providers or to join a dispute resolution scheme.

5.2. Having said that, the Exercise Association suspects that this adverse consequence of the change is unintentional and therefore asks for a solution. There is a direct parallel with the unintended consequences that flowed from the broad definitions of "financial service providers" in the FSP Act, which led

[1] New Zealand Treasury: *Best Practice Regulation: Principles and Assessment* February 2015.

to the Financial Service Providers (Exemption) Regulations 2010 (FSP Regulations)[2].

5.3. There is also a direct parallel in the exemption for non-financial services businesses from the application of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act). The relevant exemption is set out in regulation 13 of the Anti-Money Laundering and Countering Financing of Terrorism (Exemptions) Regulations 2011. Regulation 13 exempts a person where a person provides "*credit in the ordinary course of a non-finance business … under a credit contract that is incidental to the supply of goods or services*".

5.4. The rationale that applies to the AML/CFT Act exemption would be equally applicable to an equivalent exemption under the FSP Act: the activities of non-financial services businesses are not those that both of the relevant Acts are seeking to address. Also, one of the core functions of the Financial Service Providers Register is to identify financial services businesses to which AML/CFT obligations apply. The AML/CFT exemption means that the remaining grounds for registration of long-term service providers are even weaker. The obvious solution is to cater for this in parallel in the FSP Regulations.

6. Recommended solution

6.1. The simplest solution would be to provide an exemption under the FSP Regulations for suppliers of services under long-term contracts in the ordinary course of a non-finance business. The current regulation 10 would exempt suppliers where there is a third party credit contract which is assigned within one working day. However it does not address the service provider's own contract. An exemption parallel to that referred to in paragraph 5.3 would be appropriate.

6.2. The Association seeks a prompt resolution to this unnecessarily complex issue.

[2] Eg see submission to the Commerce Select Committee in 2010: http://www.parliament.nz/resource/0000108843 .