Working Towards a Fairer Consumer Credit Market:

A study of the issues in New Zealand's consumer credit market and proposals for reform

Title of this Research Paper: ***Enforcement Issues***

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INTRODUCTION AND OVERVIEW

This paper sets out how the current law (being the law as at April 2019) relating to high cost lending, is enforced. It identifies the current problems with enforcement that have been recognised in the policy papers to date, and outlines the reforms proposed in the 10 October 2018 reform package. It provides information on how consumer credit regulation is enforced in Australia and the UK, and makes note of the suggestions around enforcement made by the submitters to the Ministry of Business, Innovation & Employment (MBIE)'s June 2018 Discussion Paper "Review of Consumer Credit Regulation" (the June 2018 Discussion Paper).

It makes a series of recommendations as to how to improve enforcement of the Credit Contracts and Consumer Finance Act 2003 (CCCFA) based on the research findings.

By way of overview, the Commerce Commission (the Commission) is the regulator with the responsibility for enforcing the CCCFA. All lenders that lend to consumers are required to be a member of a dispute resolution scheme, under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. In practice most complaints, either to the Commerce Commission or a dispute resolution scheme, are made by financial mentors acting in their role as advocates for the borrowers that come to the adviser for help with debt management issues.[1]

A complaint will generally be made first to the lender concerned using the lender's own internal complaints process, then to the relevant dispute resolution scheme if the complaint cannot be resolved internally. The dispute resolution scheme may endeavour to negotiate or facilitate an agreed solution as between the lender and the borrower.[2]

If it appears that the behaviour in question is a systemic problem, either in the sense that a particular lender is repeatedly engaging in poor conduct as regards more than one borrower, or that several lenders are engaging in the same type of poor behaviour, a complaint might be lodged with the Commerce Commission, either by a financial mentor or a dispute resolution scheme. The Commerce Commission response to any such complaint is affected by various considerations such as resourcing and priorities.

[1] Ministry of Social Development "Financial Mentors" <www.msd.govt.nz>. https://www.msd.govt.nz/what-we-can-do/providers/building-financial-capability/financial-mentors.html

[2] Consumer NZ "Financial disputes resolution" (11 January 2018) <www.consumer.org.nz>. https://www.consumer.org.nz/articles/financial-disputes-resolution

Several lenders that submitted the June 2018 Discussion Paper expressed the view that the current law around lender responsibility is adequate and not in need of any reform, but the issue is that the current law is not adequately enforced by the Commerce Commission.[3]

[3] See for example the submissions made by Cash Converters, Moola, EB Loans, Acorn Finance, Rapid Loans.

1. SUMMARY OF KEY RESEARCH FINDINGS

The following summarises the key research findings detailed in this paper.

There has been very little in the way of enforcement action by the Commerce Commission (to date of writing, May 2019) in relation to breaches of the Lender Responsibility Principles, with only two warning letters issued and one set of proceedings filed in court.

Dispute resolution schemes have not seen high levels of complaints about high cost lenders. There are a number of possible reasons for this, one of which is that borrowers may be reluctant to complain.

Most complaints originate from a financial mentor who has been working with a borrower. There are issues around the lack of funding of financial mentors.

MBIE's review of consumer credit regulation revealed that there are high levels of non-compliance with the Lender Responsibility Principles. A number of reforms to the CCCFA have been proposed and approved by Cabinet to address this. These include:

- A simplified process for banning directors from being involved in the credit industry,
- Introducing "fit and proper person" testing in registration of lenders,[4]
- Giving the regulator more enforcement powers, by introducing civil pecuniary penalties for breaches of the Principles and also statutory damages (so that where lending has been made in breach of suitability or affordability requirements, a standard level of statutory damages would be paid equal to the interest and fees charged) and also increasing the Commission's existing injunctive powers,[5]

[4] New Zealand does not require licensing of lenders of consumer credit. Such lenders do have to register, being financial service providers, on the Financial Service Providers register but registration only requires certain minimal criteria are met (such as the lender, its directors owner or managers are not undischarged bankrupts, have been subject to a management banning order or convicted of a crime of dishonesty- see Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 14).

[5] Currently the Commission's injunctive power is restricted to "restraining a person from engaging in conduct" that would breach the CCCFA. This is inapt for the lender responsibilities, which are positive duties on lenders. Under

- Creating a duty of due diligence for directors and senior managers of lenders (so that directors and senior managers would be subject to duties to take reasonable steps to ensure that the creditor complies with its CCCFA obligations),

- Imposing greater obligations on lenders to substantiate their assessments (meaning lenders will have an obligation to substantiate their affordability and suitability assessments, and must supply a copy on request to the borrower (or their agent) or the Commerce Commission),

- Having more prescription around what is required in order to assess suitability and affordability (meaning mandatory requirements would be introduced for some types of lenders and loans to assess affordability in accordance with a defined procedure). The key benefit identified by MBIE of this reform is that clearer legal obligations are likely to make non-compliance easier to identify and prove, and therefore make enforcement easier,[6]

- Limiting the ability of lenders to rely on what the borrower tells them. Section 9C(7) of the CCCFA currently provides that for affordability and suitability requirements, "the lender may rely on information provided by the borrower or guarantor unless the lender has reasonable grounds to believe the information is not reliable". This reform would remove this provision. This would mean lenders would need to obtain more objective verification of key borrower information where it was warranted as part of undertaking reasonable inquiries,

- Having more prescriptive requirements around advertising (meaning that some or all of the current Responsible Lending Code guidance for advertising would be made binding), and

- Requiring disclosure to be in the same language as the advertising (meaning there would be a mandatory requirement that disclosure statements be provided in the language that the borrower is most comfortable communicating in, if the lender advertised in that language).

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this reform, if a lender has breached the CCCFA, or is likely to breach it, the Commerce Commission would be able to seek injunctions for the purpose of ensuring that the lender is compliant with the CCCFA.

[6] See MBIE's Impact Statement Consumer Credit Regulation Review, (Impact Statement) 33, available from https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-credit-law/review-of-consumer-credit-law-2018/

Under-enforcement of the existing law was identified by several submitters to the June 2018 Discussion Paper as a problem and cause of irresponsible lending in the high cost lending market. Many suggestions were made by submitters (both lenders and consumer groups) aimed at improving enforcement including the following:

- the Commerce Commission being required to regularly audit all high cost lenders;
- having a national database of high cost loans (to assist lenders to assess affordability and suitability);
- lenders being required to have a designated compliance officer;
- introducing a rebuttable presumption (as in Australia) where a loan is presumed to be unsuitable if the borrower is in default under another high cost loan or has held two or more other high cost loans in the past 90 days;
- mandatory credit reporting by lenders;
- mandatory reference of borrowers in default to a dispute resolution scheme (for example, lenders would have to refer the matter to a dispute resolution scheme if the borrower defaulted within 3 months of the loan being taken out);
- mandatory involvement of a financial mentor before a loan is made if a borrower's income is below a certain level;
- more prescription around what is required of lenders in order to comply with the Lender Responsibility Principles and specifically that if certain "red flags" are raised, additional prescribed steps must be taken by the lender when assessing affordability and suitability; and
- more resourcing for both financial mentors and the Commission.

Most of these suggestions are not included in the reforms that have been proposed by MBIE and included in the bill introduced in April 2019 (the Credit Contracts Legislation Amendment Bill, available from http://www.legislation.govt.nz/bill/government/2019/0131/latest/LMS184169.html). The idea

of a rebuttable presumption is being considered by MBIE in the context of the regulations that sit behind the bill (expected to be circulated in draft in August 2019 for consultation). Those regulations will also give detail of the prescription around affordability assessments that MBIE is proposing. It is expected that some of the current guidance in the Responsible Lending Code will be included in the regulations and be made mandatory.

2. RECOMMENDATIONS

The following recommendations are made to improve enforcement of the CCCFA:

1) Increased funding for the Commerce Commission to enable more proactive enforcement of the CCCFA obligations on high cost lenders and for financial mentors to assist borrowers who seek out their services, particularly to facilitate advocating for borrowers where there appears to have been breaches of the CCCFA;

2) Introducing an obligation on high cost lenders to prominently state in all advertising and on websites that borrowers have the right to complain to the lender's dispute resolution scheme (with name and contact details of the scheme), and that borrowers have free budgeting services available to them (with contact details of local budgeting services);

3) Introducing an obligation requiring the lender to refer the matter to the lender's dispute resolution scheme if a borrower defaults on a loan within a certain period after the loan is taken out (we recommend that period be two months);

4) Every high cost lender should be required by law to have a designated compliance officer who is responsible for ensuring that the lender has systems in place to comply with all CCCFA obligations and to monitor staff compliance;

5) Introducing a rebuttable presumption into the CCCFA which presumes that a loan is in breach of the lender responsibility principles (specifically s 9C(3)(a)) if the borrower is currently in default on another high cost loan or has been in default on a high cost loan in the last three months or if the borrower has taken out three or more high cost loans in the last twelve months;

6) Prescription should be included in regulations around how lenders must comply with the lender responsibility principles. This is already part of the reforms that

have been approved by Cabinet but as at date of writing (May 2019) we do not have the detail of what will be proposed in the regulations. In the case of high cost loans, the prescription should be particularly clearly defined and state what inquiries are required in relation to assessments of borrowers' income and expenses.

In addition, the recommendations of the research paper on interest rates are supported and repeated, noting that introduction of an interest rate cap and a protected earnings cap will be significant aids in enforcement of the CCCFA and the reduction of irresponsible lending. The Government should also investigate the possibility of having a national database of high cost loans to enable high cost lenders and other lenders to access information on a borrower's history of use of high cost loans. This measure also supports recommendation 5.

3. THE COMMERCE COMMISSION

The Commerce Commission is currently the enforcement agency of the CCCFA. Part 4 of the CCCFA contains the enforcement and remedies provisions.

a. Commerce Commission Complaints Process

The Commission receives thousands of complaints every year, therefore must prioritise investigations. The Commission's focus is to "make sure New Zealand markets work well and consumers and businesses are confident when buying or selling goods and services".[7] This means that the Commerce Commission is likely to only investigate issues when there is a risk of widespread harm to New Zealanders.[8]

When deciding whether to investigate a complaint, the Commerce Commission applies the following enforcement criteria:

- Extent of detriment;
- Seriousness of conduct;
- Public interest.[9]

<u>Extent of detriment</u>

[7] Commerce Commission "Make a complaint" (September 2018) <www.comcom.govt.nz>.
[8] Commerce Commission "Complaint process" (September 2018) <www.comcom.govt.nz>.
[9] Commerce Commission "Enforcement criteria" (September 2018) <www.comcom.govt.nz>.

The greater the likely level of detriment arising from the conduct in question, the more likely it is that the Commerce Commission will take or continue with enforcement action. In assessing detriment, factors that the Commission take into account include:

- Are the more vulnerable targeted by the behaviour?
- Are a wide range of consumers or businesses likely to be affected?
- Loss of property?
- Increased costs?

Seriousness of conduct

The more serious the conduct, the more likely it is that the Commerce Commission will begin or continue enforcement action. In particular the Commission will consider:

- Is the conduct deliberate, reckless or very careless?
- Is the conduct repeat or ongoing behaviour?
- Is there likely to be a contravention of a per se provision?
- Is there a serious departure from expected lawful commercial behaviour?

Public interest

In applying the criteria, the Commerce Commission is also mindful of the changes it wishes to achieve from taking or continuing enforcement action in each matter. It will consider:

- Is there likely to be a widespread public interest in the issue?
- Is it more appropriate for the Commission, rather than another agency or an affected party, to address the issue?
- Do the personal circumstances of the parties involved argue for or against enforcement action? (This relates to the vulnerability of parties).[10]

b. Commerce Commission's Enforcement Actions in relation to the Lender Responsibility Principles

In the time since the insertion of the Lender Responsibility Principles in the CCCFA in June 2015 and until the writing of this report (April 2019), the Commerce Commission has sent out two warning letters to lenders and commenced one set of proceedings. Proceedings were filed against Ferratum New Zealand Ltd on 1 June 2018 alleging breaches of the Lender Responsibility Principles. No settlements were entered into or other prosecutions taken by the Commerce Commission against lenders for breaches of the Lender Responsibility Principles.

[10] Commerce Commission "Enforcement criteria" (September 2018) <www.comcom.govt.nz>.

41 warnings, infringement notices, settlements or prosecutions were completed for breaches of other CCCFA provisions over the period of June 2015 to March 2019.[11] These were mostly for disclosure breaches.

MBIE has noted that this emphasis on breaches of other CCCFA provisions (in other words, not the Lender Responsibility Principles) reflects the relative complexity of bringing cases relating to irresponsible lending, the lack of penalties for irresponsible lending, and the priority placed by the Commerce Commission on taking action quickly to stop harm – particularly in the mobile trader sector over this period.[12]

Warning letters are considered by the Commerce Commission to be a low level response. It is the Commerce Commission's view that a lender who receives a warning letter has breached the Lender Responsibility Principles and the letter is intended to prompt a change in the lender's behaviour and to encourage future compliance.[13] Warning letters are issued as an alternative to litigation where it is considered that:

- The evidence that has been gathered is sufficiently strong to establish a prima facie case; and
- There has therefore been a breach or likely breach of the law; but
- The matter can be satisfactorily resolved without legal proceedings.

A warning letter sent by the Commerce Commission will:

- Advise the recipient that, in the Commission's opinion, it has or is likely to have breached the law, and state the reasons;
- Explain what court penalties could be imposed for such a breach;
- Explain that, in this instance, the Commission has exercised their discretion to issue a warning rather than to take legal proceedings; and
- State that in cases of continued or repeated similar conduct, the Commission may rely in their enforcement decision-making on the fact of having already issued a warning letter.

The Commission may also draw that fact to the attention of a court in any subsequent proceedings brought by them against the recipient.[14]

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[11] Commerce Commission "Case Register" (Searched 21 March 2019) <www.comcom.govt.nz>.

[12] Ministry of Business, Innovation and Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 44.

[13] Commerce Commission *Enforcement Response Guidelines* (October 2013) at 8.

[14] Commerce Commission *Enforcement Response Guidelines* (October 2013) at 8.

Warning Letter to Dealer Finance Ltd (19 March 2018)

The first warning letter issued to deal with a likely breach of the Lender Responsibility Principles was issued on 19 March 2018 to Dealer Finance Ltd (DFL). The likely breach was that DFL did not make reasonable inquiries before entering into agreements with borrowers, so as to be satisfied that it was likely that the borrowers would make payments under the agreements without suffering substantial hardship. Therefore, there was a likely breach of s 9C of the CCCFA by failing to comply with the Lender Responsibility Principles. This letter was issued by the Commerce Commission in response to three complaints received from borrowers who alleged that they suffered substantial hardship as a result of making payments under loans granted by DFL.[15]

In the three cases of the borrowers, the Commerce Commission was concerned that either:

- DFL obtained insufficient financial information, particularly income and expenses information about the borrower, or
- DFL did not sufficiently take into account other relevant information when considering whether the borrower would be able to make payments under the agreement without suffering substantial hardship.[16]

The Commerce Commission's findings in this warning letter were that DFL's conduct likely breached s 9C(1) of the CCCFA, stating that every lender must comply with the Lender Responsibility Principles, by not complying with the obligations set out in ss 9C(2)(b) and 9C(3)(a)(ii) of the CCCFA. Section 9C(3)(a)(ii) states that a lender must, in relation to an agreement with a borrower, make reasonable inquiries, before entering into the agreement, so as to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship.[17]

Warning Letter to Rapid Loans NZ Limited (9 October 2018)

The second warning letter issued to deal with a likely breach of the Lender Responsibility Principles was issued on 9 October 2018 to Rapid Loans NZ Limited (RLL). The likely breach was, similarly to DFL, that RLL did not make reasonable inquiries before entering into consumer credit contracts with a vulnerable borrower, in April and September 2016, so as to be satisfied that it was likely that the borrower would make payments under the agreement without suffering

[15] Commerce Commission "Warning letter to Dealer Finance Ltd" (19 March 2018) <www.comcom.govt.nz>.

[16] Commerce Commission "Warning letter to Dealer Finance Ltd" (19 March 2018) <www.comcom.govt.nz>.

[17] Credit Contracts and Consumer Finance Act 2003, s 9C.

substantial hardship. In particular, RLL failed to make reasonable inquiries into the borrower's income and expenses and likelihood of repayment, by

- Failing to take into account deductions to the borrower's income; and
- Not making any inquiries about the borrower's cash withdrawals when calculating the living costs.

The borrower was in a negative cash flow position at the time the loans were applied for.[18]

As a result, there was a likely breach of s 9C of the CCCFA by failing to comply with the Lender Responsibility Principles. This letter was issued by the Commerce Commission in response to a complaint from a financial mentor who advised the borrower and alleged that the borrower suffered substantial hardship as a result of making payments under loan agreements with RLL.

The Commerce Commission's findings in this warning letter were that RLL's conduct likely breached s 9C(1) of the CCCFA, stating that every lender must comply with the Lender Responsibility Principles, by not complying with the obligations set out in ss 9C(2)(b) and 9C(3)(a)(ii) of the CCCFA. Section 9C(3)(a)(ii) states that a lender must, in relation to an agreement with a borrower, make reasonable inquiries, before entering into the agreement, so as to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship.[19]

The Commission investigated the affordability assessments for two loans Rapid Loans entered into with the borrower during 2016. The investigation found that:

- Rapid Loans assessed the borrower's income and expenses solely from 4 weeks' of bank statements provided by the borrower and a copy of WINZ payment advice,
- The borrower was at her overdraft limit of approximately $500 at the time both the April 2016 and September 2016 loans were entered into,
- The borrower used the loans she obtained from Rapid Loans to meet her repayment obligations on existing loans with Rapid Loans. In addition, Rapid Loans included further credit fees and a top up of further credit fees and a top up of further credit to the borrower over and above the amount to pay off the current loans, increasing the borrower's vulnerability as her weekly repayment obligations increased,
- The borrower had defaulted on the April 2016 loan, which was her reason for applying for the September 2016 loan. She defaulted on this loan after 1 month and 8 days, and
- Rapid Loans had incorrectly calculated both income (in particular relating to WINZ benefit payments) and expenses for the borrower.

[18] Commerce Commission "Warning letter to Rapid Loans NZ Limited" (9 October 2018) <www.comcom.govt.nz>.
[19] Credit Contracts and Consumer Finance Act 2003, s 9C.

The Commerce Commission found that RLL was provided with eight weeks' worth of bank statements during the application phase; however, enquiries were limited to only four weeks' worth and a copy of the borrower's WINZ payment advice. It was the view of the Commerce Commission that this did not provide a sufficient basis on which RLL could be satisfied the borrower would be able to make payments under the loan agreement without suffering substantial hardship.

The fact that RLL failed to make inquiries about the borrower's circumstances meant that it was not able to properly assess the information it received from the borrower's bank statements. For example, it treated the borrower's cash withdrawals as discretionary spending, when there was no reasonable basis on which to do so. It also failed to make any allowance for the borrower's rent or power.

The borrower was advanced $1,850 in April 2016 and even though she was in a default position, RLL advanced her a further $2,500 in September 2016. The Commission considered that RLL should have made more extensive inquiries into the borrower's income and expenses to comply with the Lender Responsibility Principles. The Commission considered that this borrower was likely a vulnerable borrower under the Responsible Lending Code,[20] meaning that more extensive inquiries were required. If RLL had conducted an affordability assessment using the income received into the borrower's bank account and correctly determined the living expenses, the borrower would have been left in a negative weekly surplus on the Commission's calculations and RLL should not have provided the two loans. In the Commission's view, any borrower with a negative weekly deficit after making the loan payments is at risk of substantial hardship if they are allowed to enter into a loan.[21]

Proceedings against Ferratum New Zealand Limited

The Commerce Commission commenced High Court proceedings on 1 June 2018 against payday lender Ferratum New Zealand Limited (Ferratum) over alleged breaches of the Lender Responsibility Principles.

[20] Behind the Lender Responsibility Principles sits the Responsible Lending Code (the Code) which elaborates on the Principles and provides guidance as to how lenders can comply with the Principles. The Code is non-binding, and non-compliance currently attracts no enforcement consequences. Evidence of a lender's compliance with the provisions of the Code will be treated as evidence of compliance with the Principles, including the specific lender responsibilities. See Credit Contracts and Consumer Finance Act 2003, s 9E(3).

[21] Commerce Commission "Warning letter to Rapid Loans NZ Limited" (9 October 2018) <www.comcom.govt.nz>.

The Commission also seeks to reopen some of Ferratum's loans on the grounds that they were induced by oppressive means and contained oppressive terms.[22]

The Commission alleges that between mid-2015 and the present, Ferratum:

- failed to make reasonable enquiries as to the borrower's requirements and objectives
- failed to exercise reasonable care in advertising loans
- failed to assist borrowers to reach informed decisions as to whether or not to enter into loans.

The Commission also alleges that this conduct, together with interest rates in excess of 183%, were oppressive.[23]

<u>Possible investigation into Superloans</u>

As of December 2018, Stuff has reported that the Commission has launched an investigation into Superloans, which provide high cost short term loans, after it received more than 20 complaints against the company since 2013. [24] Several of these have been from financial mentors.

Copies of the complaints were obtained under the Official Information Act and reveal allegations that Superloans threatened to take repayments out of a person's pay cheque, illegally.

Another complaint made was that a Superloans employee only looked at her bank statements before approving her loan application and did not check her credit.[25]

It has been stated[26] that many of these complaints lodged with the Commission against Superloans would fall under misconduct that the Financial Services Complaints could investigate and award compensation for, as Superloans is a member of the scheme.[27]

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[22] Credit Contracts and Consumer Finance Act 2003, s 120.

[23] Commerce Commission "Commission alleges irresponsible lending by payday lender Ferratum" (press release, 1 June 2018).

[24] Julie Iles "Short-term loan, long-term debt: Superloans under investigation after slew of complaints" (26 November 2018) Stuff <www.stuff.co.nz>.

[25] Julie Iles "Short-term loan, long-term debt: Superloans under investigation after slew of complaints" (26 November 2018) Stuff <www.stuff.co.nz>.

[26] Julie Iles "Financial services watchdog 'surprised' to see so few payday lender complaints" (27 November 2018) Stuff <www.stuff.co.nz>.

[27] Credit Contracts and Consumer Finance Act 2003, s 9C(3)(f). The lender must meet all their legal obligations to the borrower, including under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Section 11 of this Act states that a person cannot be in the business of providing a financial service unless they are a member of an approved dispute resolution scheme. Section 48 of this Act requires every financial service provider to be a member of an approved dispute resolution scheme in respect of a financial service provided to a retail client.

Superloans is likely to be or is being investigated under the Lender Responsibility Principles, but at date of writing (May 2019), there is no mention of a case against Superloans on the Commerce Commission's Case Register.[28]

4. DISPUTE RESOLUTION SCHEMES

a. Requirements

One of the Lender Responsibility Principles requires lenders to meet all their obligations under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP (RDR) Act), amongst other legal obligations under the Fair Trading Act 1986, the Consumer Guarantees Act 1993, and the Financial Advisers Act 2008.[29]

Section 5 of the FSP (RDR) Act includes creditors under a credit contract within the meaning of "financial service".[30] Section 11 of the FSP (RDR) Act states that a person cannot be in the business of providing a financial service unless they are registered to provide a financial service and are a member of an approved dispute resolution scheme (DRS). They must not also hold out that they are registered or that they are a member of an approved dispute resolution scheme.[31] Section 48 of the FSP (RDR) Act requires every financial service provider to be a member of an approved dispute resolution scheme in respect of a financial service provided to a retail client.[32]

b. Current dispute resolution schemes in New Zealand

All dispute resolution schemes are free to consumers and resolve complaints between consumers and their scheme participants. This is as an alternative to legal proceedings for resolving financial services disputes. To be an approved dispute resolution scheme, the dispute resolution scheme must be accessible, independent, fair, accountable, efficient and effective.[33]

[28] As of 13/05/19.
[29] Credit Contracts and Consumer Finance Act 2003, s 9C(3)(f).
[30] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 5(1)(e).
[31] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 12.
[32] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 48(1).
[33] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 52(2).

There are four schemes currently approved to provide financial dispute resolution services.

Financial Services Complaints Ltd

Financial Services Complaints Ltd (FSCL) was the first dispute resolution scheme approved under the FSP (RDR) Act.[34] They deal with disputes about a financial services provider who is a financial dispute resolution scheme participant.[35]

In the year ending 30 June 2018, FSCL reported a 35% increase in complaints opened for investigation, or disputes.[36] Complaints also had an 11% increase in the year ending 30 June 2018.[37] Fifty one complaints about lenders were formally investigated and approximately 2,000 initial complaints and enquiries about lenders were handled.[38]

When FSCL first receives a complaint or enquiry, it checks to see if the scheme participant has had the opportunity to resolve the complaint directly with their client. If not, FSCL helps the complainant take their complaint to the participant and follow up later to check that it has been resolved. A formal investigation is only opened where:

- the complainant has been unable to resolve their complaint with the scheme participant
- a complaint is unresolved after 40 days of being made to a participant, or
- a participant tells their client to take their complaint to FSCL.[39]

It is noted that the consumer should refer their complaint to FSCL if

- The consumer is unable to resolve the complaint with the financial service provider;
- The complaint is unresolved after 40 working days of making a complaint to the financial service provider;
- The financial service provider tells the consumer to take their complaint to FSCL.

In the decision-making process, the Chief Executive Officer will then give the consumer either:

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[34] Financial Services Complaints Ltd "Busiest year on record for Financial Services Complaints Ltd" <www.fscl.org.nz>.

[35] Consumer Protection "Resolve a problem" <www.consumerprotection.govt.nz>. https://www.consumerprotection.govt.nz/report-or-resolve-a-problem/banking-finance-and-insurance/banking-finance-and-insurance/

[36] Financial Services Complaints Ltd "Busiest year on record for Financial Services Complaints Ltd" <www.fscl.org.nz>.

[37] Financial Services Complaints Ltd "Annual Report 2017/18" <www.fscl.org.nz>.

[38] Financial Services Complaints Ltd *Review of consumer credit regulation* (27 July 2018) Ministry of Business, Innovation & Employment <www.mbie.govt.nz> at 1.

[39] Financial Services Complaints Ltd "Annual Report 2017/18" <www.fscl.org.nz>.

- A preliminary view, explaining why they think the complaint is unlikely to succeed, or
- A notice of recommendation, advising how the complaint should be resolved, including what compensation should be paid by the financial service provider.[40]

FSCL stated in its submission to the June 2018 Discussion Paper that the scheme receives "relatively few complaints about high cost lending" and that it is "surprising because [they] hear anecdotal evidence that many consumers get into spirally debt situations after accessing high cost lending". This may be due to consumers being unaware of their right to complain and that they also rely on this type of lending for necessities. This is acknowledged by FSCL when they stated that "consumers may be reluctant to complain about high cost lending because they rely on the lending to meet their day to day living costs".[41]

Insurance & Financial Services Ombudsman

The Insurance & Financial Services Ombudsman (IFSO) similarly receives complaints after the complainant has come to the end of the participant's internal complaints procedure and the complaint cannot be resolved, which they call "deadlock".[42] This scheme deals with complaints about insurance, loans or credit, superannuation, financial advisors, investments or other financial services provided by the IFSO participants.[43]

The IFSO requires a completed IFSO Scheme Complaint Form and a letter of deadlock from the consumer before a case manager will review the file. The IFSO will decide the method and process to be used to resolve the consumer's complaint, including: negotiation, conciliation and mediation. The case manager can help resolve the complaint by discussing with the complainant and the participant, which is a settlement. The case manager can make a decision if the complaint cannot be settled and if the parties agree on this decision, the IFSO will close the file. If it is not agreed upon, then the file will be closed and the complainant can refer their complaint to a court or any other disputes resolution process. The complainant's rights are not compromised by making a complaint to the IFSO.[44]

[40] Financial Services Complaints Ltd "How to make a complaint" <www.fscl.org.nz>.
[41] Financial Services Complaints Ltd *Review of consumer credit regulation* (27 July 2018) Ministry of Business, Innovation & Employment <www.mbie.govt.nz> at 1.
[42] Insurance & Financial Services Ombudsman "Glossary" <www.ifso.nz>.
[43] Consumer Protection "Resolve a problem" <www.consumerprotection.govt.nz>.
[44] Insurance & Financial Services Ombudsman "IFSO Scheme Complaints process" <www.ifso.nz>.

The IFSO can investigate complaints about a participant of their scheme relating to:

- House, contents, vehicle, travel, health, income protection and life insurance; superannuation; investments; financial advice or planning (including brokers); loans and credit; and any other financial services provided by a participant,
- Breaches of contract, statutory obligations, industry codes, and
- Complaints by small businesses.

The IFSO cannot investigate complaints about:

- Amounts in dispute over $200,000, or $1,500 per week for a product that provides regular payments,
- Awards of damages,
- Third party or uninsured losses,
- Financial service providers' commercial decisions, including: returns, premiums, charges, excesses, and underwriting decisions,
- Complaints which are, or have been, the subject of proceedings in another forum e.g. a decision has already been made in the courts or that have been settled in mediation, or
- A financial service provider which is not a member of the IFSO Scheme.[45]

Banking Ombudsman Scheme

The members to the Banking Ombudsman Scheme include all of the main banks and their subsidiary or related companies, along with several credit unions and building societies.[46]

The complaints the Banking Ombudsman can consider are most types of banking related complaints, but complaints outside their scope are:

- Complaints about a bank's commercial judgement,
- Complaints about a bank's interest rate policies or the size of its standard fees and charges,
- Complaints involving claims of direct financial loss above $200,000,
- Complaints about matters that happened a long time ago,
- Complaints better dealt with by another agency or dispute resolution scheme (for example, the Insurance and Financial Services Ombudsman, Commerce Commission, Financial Markets Authority, Privacy Commission or Human Rights Commission), and
- Complaints already resolved with the bank.

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[45] Insurance & Financial Services Ombudsman "Complaints the IFSO Scheme can consider" <www.ifso.nz>.

[46] Banking Ombudsman Scheme "Our participants" <www.bankingomb.org.nz>.

The Banking Ombudsman can give consumers information, but not advice, about:

- Banking industry practices and procedures,
- How to make a complaint about a bank, and
- Banks' legal obligations and industry codes.

The Banking Ombudsman cannot give advice about a particular bank's products or services, or financial, legal or budgeting advice.[47]

Financial Dispute Resolution Service

Financial Dispute Resolution Service (FDRS) helps individuals and small-to-medium businesses (those with fewer than 20 full-time employees or the equivalent) to resolve any issues with their financial service provider. If the complainant's financial service provider is registered with Financial Dispute Resolution Service, then this scheme can help resolve disputes.[48]

Financial Dispute Resolution Service has an Advisory Council to monitor and advise the scheme. The stages of the complaints process are:[49]

1. Enquiry and early resolution
    - The first step is to ensure that the complainant's financial service provider has been made aware of the complaint and has an opportunity to resolve it through the Scheme Member's internal complaint process.
    - If the complainant has already made a complaint to the Scheme Member and is not satisfied with their response, or two months have passed since they made the complaint, FDRS will open a complaint file.
2. Investigation, facilitation and resolution
    - If the Scheme Member declines to resolve the complaint and once their response is received, a copy of their response is provided to the consumer and an assessment is undertaken to decide the most suitable way to deal with the complaint. The choices are:
        i. Facilitation
            1. The Facilitation phase is used to try and guide the parties to an agreement in an informal but assisted manner. At the successful completion of this stage (i.e. agreement is reached) the parties sign a settlement agreement that binds both parties.
        ii. Conciliation

[47] Banking Ombudsman Scheme "Complaints we can consider" <www.bankingomb.org.nz>.

[48] Financial Dispute Resolution Service "About us" <www.fdrs.org.nz>.

[49] Financial Dispute Resolution Service "How we work" <www.fdrs.org.nz>.

1. The Conciliation phase is mediation where the conciliator is permitted to have input into the content of the complaint as well as the process. This stage is undertaken by a Resolution Practitioner who has completed formal mediation training. At the successful completion of this stage (i.e. agreement is reached) the parties sign a settlement agreement that binds both parties.
2. If the complaint cannot be resolved through facilitation or mediation, it moves into the Adjudication stage, which is a formal decision-making process.

iii. Adjudication.

3. Formal adjudication
    - The Adjudication stage is undertaken by the Resolution Practitioner and the Adjudicator.
    - All information that is needed to make a formal decision is obtained (including such items as reference materials or an expert opinion). This information is provided to both parties.
    - Working with the Resolution Practitioner, the Adjudicator drafts a formal decision with reference to the law, good industry practice and what is fair and reasonable in all the circumstances. The draft includes the decision the Adjudicator is proposing to make.
    - The draft adjudication is provided to both parties and comments are requested. The Adjudicator takes the parties' comments into account and issues the final decision.
    - At the completion of this stage the Scheme Member is bound by the decision if it is accepted by the consumer. The consumer is also bound but only if he/she accepts the decision in full.
    - If both parties accept the decision a binding agreement document or Deed of Release is drafted by the Resolution Practitioner and signed by both parties and the case is closed.

c. Case example involving high cost lending from Financial Services Complaints Ltd.[50]

$800 payday loan becomes a $2,000 debt

The story

William is 21, employed, earning $42,000 a year. William did not have quite enough money to cover his expenses so applied to a payday lender, Phone for Cash, for a $100 loan to be repaid the following week. William completed an application, provided proof of income and the loan was advanced. William repaid the loan on time, without incident. A couple of weeks later William was again short of money. He called Phone for Cash and asked for a $200 loan to be repaid the following week. Again William repaid the loan on time. A few weeks later William borrowed $400. This time William could not repay the loan and defaulted. William asked his father for help and fortunately William's father was able to repay the debt.

A few months later, in August, William applied to Phone for Cash for a loan of $800. William knew he would need to pay Phone for Cash $1,264 within 45 days. William did not repay the loan and Phone for Cash began its debt recovery process, sending text messages and trying to contact William by telephone. In October Phone for Cash demanded immediate payment of $1,372. By November the debt had increased to $1,586 when Phone for Cash again tried to contact William. In January Phone for Cash made its third demand for $1,766, advising the debt would be referred to a collection agency. William did not respond until February when he asked his father for help.

Phone for Cash asked William to see a budget adviser. The budget adviser said William could afford to pay $75 a week. Phone for Cash said this was not enough, and wanted William to pay $600 a week. William phoned FSCL in March, by now his debt was $2,070.

Dispute

William agreed he owed Phone for Cash $2,070 but said it was impossible for him to pay $600 a week. William said he thought Phone for Cash should not have loaned him $800 after he had defaulted on the previous loan. William asked for our help to negotiate with Phone for Cash.

FSCL's review

[50] Financial Services Complaints Ltd *Review of consumer credit regulation: Appendix 1 FSCL Case Notes* (Ministry of Business, Innovation & Employment, 27 July 2018) <www.mbie.govt.nz> at 3; Financial Services Complaints Ltd "Case Studies: $800 payday loan becomes a $2,000 debt" (2015) <www.fscl.org.nz>.

We asked Phone for Cash whether it would accept anything less than $600 a week, explaining this was an unrealistic sum. Phone for Cash said it had tried working with William. William had ignored the demands for payment. Phone for Cash was not prepared to accept $75 a week from William, it was barely enough to keep pace with the interest, and Phone for Cash was concerned William would again default. Phone for Cash explained that the administrative time in following up defaulting debtors is uneconomic and it had made the commercial decision to refer the debt for collection.

We explained to William that under our terms of reference we cannot interfere with commercial decisions in relation to debt and security. We could not see that Phone for Cash had done anything wrong. Phone for Cash had followed a reasonable application process, William had a relatively good history of repaying debt and had not contacted Phone for Cash early when he knew he could not repay the loan.

We asked William whether he could approach his father again for help. Even if he was not able to raise the full amount needed to repay the debt we said we would help him to negotiate with Phone for Cash if he could improve the repayment offer.

Outcome

William contacted us about a week later to say he had been able to repay the Phone for Cash debt in full. We discontinued our investigation.

5. THE ROLE OF FINANCIAL MENTORS

Financial mentors (otherwise known as budget advisors) provide a one-on-one service focusing on empowering people to get control of their money. They work alongside a person, their family and whānau, building trust and taking into account the complexity of their needs. A financial mentor is usually the first person that a consumer would see if they are experiencing issues on loan repayments and it is recommended that the consumer receives advice before they miss a payment.[51]

Financial mentors have a non-judgmental approach and sound financial knowledge. They support people to make connections with local networks and social services to ensure they get the right support at the right time (these can include Work and Income, support services for mental health, addictions, housing, etc.)

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[51] Commerce Commission *Problems with your loan* (March 2016) at 3.
https://comcom.govt.nz/__data/assets/pdf_file/0030/89652/Problems-with-your-loan-Guide-March-2016.pdf

This could mean the financial mentor:

- supports and empowers clients to navigate the system to control debt by negotiating reduced payments or generating additional resources, and/or
- advocates on a client's behalf as they are often too stressed to negotiate with creditors or other lenders on their own.[52]

A financial mentor can help with consumers' personal budgeting by putting together a plan to get out of debt, start saving and achieve long-term sustainable change.[53] FinCap offers support to all budgeting and financial capability services in New Zealand and is supported by the Ministry of Social Development as part of their Building Financial Capability [BFC] initiative.[54] FinCap supports 199 budgeting organisations in 300 locations with over 60,000 clients accessing these services every year.[55] Anyone experiencing financial hardship can use the financial mentoring services for free.

a. Issues with funding

Funding allocation to budgeting services is determined by the Ministry of Social Development (MSD) and uses an evidence-based investment model to ensure that funding is invested in the areas of greatest need. This model uses population-based indicators to express the relative level of need for financial mentoring services in each region. There are nine population indicators used by MSD:

- Number of families earning less than $50,000 per annum;
- Number of Hardship Emergency Grants, including Special Needs Grants;
- Māori population from the 2013 census;
- Number of single parents with dependent child(ren);
- Number of families receiving Working for Families Support;
- Pacific population from the 2013 census;
- Number of clients receiving and Accommodation Supplement Benefit;
- Number of people who experienced personal insolvency;
- Number of people aged 20-24 with no qualifications.[56]

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[52] Ministry of Social Development "Financial Mentors" <www.msd.govt.nz>. https://www.msd.govt.nz/what-we-can-do/providers/building-financial-capability/financial-mentors.html

[53] Credit Simple "Get free budgeting advice, no matter where you are in New Zealand" <www.creditsimple.co.nz> http://content.creditsimple.co.nz/national-building-financial-capability-charitable-trust/

[54] FinCap "About Us" <www.fincap.org.nz> https://www.fincap.org.nz/about-us/

[55] FinCap "Positive financial futures for people, whānau and families [Home]" <www.fincap.org.nz>

[56] Ministry of Social Development "Funding allocation model" <www.msd.govt.nz>. https://www.msd.govt.nz/what-we-can-do/providers/building-financial-capability/funding-allocation-model.html ;

However, with this model of funding allocation, problems with lack of funding remain. In 2014, a Cabinet Paper released showed that budgeting services struggled to meet the ongoing levels of demand for services.[57] In 2016, there was a 25% reduction in frontline funding for budgeting services, but there was still the need for the same number of clients to be advised.[58] Issues with funding remain in 2018 where services are not funded, therefore cannot stay open even though they are struggling to meet demand. A recent example of this is Marlborough Family Budgeting Service in Blenheim, which is described as a "high needs area"[59], closing their doors on 14 December 2018, whereas they were given funding by the Ministry of Social Development in 2016. Another social service provider in the area, Maataa Waka, was described as already being "over-subscribed" and at capacity.[60]

Ministry of Social Development "Budgeting Services changes" (19 October 2016) <www.msd.govt.nz>. https://www.msd.govt.nz/about-msd-and-our-work/newsroom/media-releases/2016/budgeting-services-changes.html

[57] Paula Bennett *Cabinet Paper: Budgeting Services Funding Review* (The Treasury, July 2014 Budget 2014 Information Release; Minister of Social Development Letter 14 November 2013) <www.treasury.govt.nz>. https://treasury.govt.nz/sites/default/files/2018-02/b14-2921475.pdf

[58] Radio New Zealand "Budgeting service funding to be slashed" (7 June 2016) <www.radionz.co.nz>. https://www.radionz.co.nz/news/political/305818/budgeting-service-funding-to-be-slashed

[59] Areas that have been said to be in "high need" are low-income areas where brick and mortar high cost lenders cluster. These lenders appear to cater to many customers with poor credit records, therefore do not have alternative sources of credit. This incentivises high cost lenders to overlook the unaffordability of the loans, in order to profit from this under-served segment of the borrower market. Irresponsible lending is likely to occur in a higher proportion in these areas. See Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 15.

[60] Paula Hulburt "'Heart-breaking': Family budget service to close before Christmas" (4 December 2018) Stuff <www.stuff.co.nz>. https://www.stuff.co.nz/national/109044328/heartbreaking-family-budget-service-to-close-before-christmas

b. Consumers' reluctance to complain

The numbers of complaints to the Commerce Commission under the CCCFA have risen over the years and in 2017-18, the conduct most complained about were debt collection, responsible lending, disclosure and fees (respectively, 125, 84, 65 and 54 complaints were received).

	2009	2010	2011	2012	2013	2014	2015	2016-17 (1 July 2016-30 June 2017)	2017-18
Complaints	330	255	266	151	191	146	164	242	318[61]

These numbers do not include the complaints that are directly resolved by financial mentors after receiving complaints from consumers (however, as explained above, financial mentors also do not have enough resources to meet demand for their services). However, even after taking this into account, there is still likely to be under-reporting of issues in lending. For example, in the MBIE Additional Information Paper that supported the June 2018 Discussion Paper, it was noted that debt-collection issues were likely to be under-reported because of consumers' reluctance to complain, which could be attributable to shame, or a lack of knowledge of rights and process surrounding complaints.[62]

Irresponsible lending practices are also likely to be under-reported because some consumers who cannot afford credit may deliberately seek out less responsible lenders, after they are turned down by responsible lenders. Given their circumstances, some of these borrowers are likely to have strong incentives to mislead lenders as to their income and expenses, and are unlikely to

[61] Commerce Commission *Consumer Issues 2016* (1 August 2016) at 31. 2016-17 data taken from Commerce Commission *Consumer Issues 2016-17* (1 August 2018) at 4. 2017-18 data taken from Commerce Commission *Consumer Issues 2017-18* (27 November 2018) at 3.

[62] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 22.

complain about irresponsible lending.[63] Consumer stakeholders have identified irresponsible lending across all types of lenders, with their reports and Commerce Commission complaints data suggesting problems are particularly concentrated across finance companies and high-cost lenders.[64]

Consumer advocates have also expressed concerns that the principles-based nature of the lender responsibilities and Responsible Lending Code makes it difficult to know what is prohibited, and when to complain about conduct to the Commerce Commission or dispute resolution schemes. This may also result in under-reporting of irresponsible lending.[65]

Complaints about mobile traders are also likely to be under-reported, as they are predominantly located in lower socioeconomic communities and many customers of mobile traders have limited financial literacy and are unable to obtain credit from other sources. These factors lead to an increased likelihood of making poor consumer decisions and a lack of knowledge of rights mean it is less likely people will raise or pursue complaints.[66]

c. Ministry of Social Development's Evaluation of Financial Mentoring Services

The Ministry of Social Development has commissioned a five-year evaluation of financial mentoring services which is to be carried out by Malatest International between July 2017 and July 2022. Results of the evaluation will assess the effectiveness of various building financial capability (BFC) services and products, which will contribute to continuous improvement of services, by identifying what is working well, any gaps and barriers in the delivery and access to services, and then sharing what has been learnt, taking action and making changes. The effectiveness of these services is being tested through a series of evaluations of BFC products and services over a five-year period, Provider Result Dashboards, as well as an impact evaluation.

[63] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 15.
[64] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 16.
[65] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 17.
[66] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 19.

The objectives of the evaluation include:

- Targeting: to assess the extent to which BFC services are well targeted to building the financial capability and resilience of the New Zealanders experiencing the highest levels of hardship,
- Client experience: to assess how well BFC services are working for those who are receiving the services,
- Effectiveness: to examine the effectiveness of BFC services in building the financial capability and resilience of New Zealanders experiencing hardship, and
- Impact and Return on Investment: to review the long term impact and return on investment of BFC services for New Zealanders experiencing hardship.

The scope of the evaluation includes understanding who is experiencing hardship and the targeting of services, understanding the client experience of service delivery, of specific BFC initiatives and how they contribute to the BFC services initiative, what results are achieved for clients, particularly Māori and Pacific clients and how the effectiveness of the initiative is influenced by community and environmental contexts.[67]

6. ISSUES WITH THE CURRENT ENFORCEMENT REGIME OPERATED BY THE COMMERCE COMMISSION (identified in the policy papers issued by MBIE or by the Commerce Commission)

In December 2017 the (then new) coalition Government commissioned the Ministry for Business, Innovation and Employment (MBIE) to conduct a review to assess whether the amendments to the CCCFA that introduced the Lender Responsibility Principles had been effective in protecting vulnerable consumers (the MBIE Consumer Credit Review). The term 'vulnerable' encompasses persons that have low literacy or numeracy skills, or are not confident speakers of English, or are

[67] Ministry of Social Development "Evaluation of BFC services" <www.msd.govt.nz> https://www.msd.govt.nz/what-we-can-do/providers/building-financial-capability/evaluation-of-bfc-services.html

under financial and or time pressure.[68] A key finding from the review, as reported in MBIE's subsequent report,[69] was that there is evidence of continued irresponsible lending.

MBIE reported that "[a]cross credit markets, there are inconsistent levels of compliance, and continued irresponsible lending by some lenders. Specific areas of significant non-compliance were in carrying out affordability assessments and in advertising practices." [70] In other words, notwithstanding the introduction of Lender Responsibility Principles in 2015, there is evidence that loans continue to be made in circumstances where the borrower could not realistically afford the repayments. Consumer groups, regulators, dispute resolution schemes and some lenders reported that was common for some lenders to perform only superficial testing of loan affordability and take income and expense information provided to them by borrowers without proper questioning or verification, even where it is plainly incomplete or incorrect.[71] This view is borne out, said MBIE, by Commerce Commission complaint statistics.[72]

Financial mentors in their submissions to the June 2018 Discussion Paper said that they are seeing clients daily who have got into an unmanageable debt situation. In many cases it appeared that the client should not have been given a loan, because they could not afford it. High cost lending was seen a significant source of problems.

The Commerce Commission put in a lengthy submission to the June 2018 Discussion Paper. That submission stated that the Commission was "aware of evidence supporting the issues identified in the Discussion Paper under the heading of continued irresponsible lending and other non-compliance."[73] The Commission said "it is apparent from our responsible lending investigations to date that lenders make differing levels of inquiries and take very different approaches to

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[68] See the October 2018 Cabinet paper (Cabinet Paper), 1, accessible at: https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-credit-law/review-of-consumer-credit-law-2018/ 'At any time, a proportion of the population is at significantly higher risk of making poor consumer decisions. General risk factors include poverty, lower proficiency in English, disability and low literacy and numeracy. These are heightened by financial shocks (like unexpected expenses or loss of income), stress or addiction.' (From MBIE's Review of Consumer Credit Regulation, June 2018, 11-12, (June 2018 Discussion Paper) accessible at: https://www.mbie.govt.nz/assets/6e872118c7/discussion-paper-cccfa-review-2018.pdf at 7).

[69] Review of Consumer Credit Regulation (the June 2018 Discussion Paper), available from https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-credit-law/review-of-consumer-credit-law-2018/

[70] June 2018 Discussion Paper, n12, 10.

[71] June 2018 Discussion Paper, n12, 17.

[72] MIBIE's Additional Information to Support the Discussion Paper, June 2018, 15, (Additional Information Document) available from https://www.mbie.govt.nz/assets/3f19e04173/background-and-technical-detail-for-discussion-paper.pdf

[73] Submission of the Commerce Commission, at [60].

affordability assessments."[74] The submission provided evidence of problems with affordability assessments, particularly in the high cost lending market. The reforms proposed by MBIE and approved by Cabinet in October 2018 are in part intended to address low levels of compliance with the Lender Responsibility Principles.

a. Lack of enforceability of the Responsible Lending Code

The purpose of the Responsible Lending Code (RLC or the Code) is "to elaborate on and offer guidance on how the Lender Responsibility Principles (including the more detailed lender responsibilities) may be implemented by lenders".[75] However, the RLC is not binding[76] so lenders are able to comply with the Lender Responsibility Principles in other ways. The Code is also not a "safe harbour", which means that compliance with the Code is not deemed to be compliance with the Lender Responsibility Principles.[77] The guidance provided in the RLC is not an exhaustive statement of what a lender should or should not do in order to be a responsible lender. However, *evidence of a lender's compliance* with the provisions of the Code will be treated as evidence of compliance with the Lender Responsibility Principles, including the specific lender responsibilities, but this will be weighed against other evidence.[78]

The RLC is intended to make it easier for lenders to determine what their obligations are and how to meet them. However, RLC is not binding, meaning that it does not hold lenders to account if they do not behave exactly as specified in RLC's guidance. This is because lenders may be able to satisfy the Lender Responsibility Principles in other ways not mentioned in the Code.[79] The principles-based nature of the requirements in the CCCFA and its non-binding nature have been identified by stakeholders as contributing to problems with non-compliance. When legal obligations are not clear, they can be difficult to apply and for the regulator to enforce.[80]

[74] Submission of the Commerce Commission, at [124].
[75] Credit Contracts and Consumer Finance Act 2003, s 9E(1).
[76] Credit Contracts and Consumer Finance Act 2003, s 9E(2).
[77] Credit Contracts and Consumer Finance Act 2003, s 9E(3).
[78] New Zealand Government *Responsible Lending Code* (Revised June 2017) at 4.
[79] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 52.
[80] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 53.

b. Lack of civil pecuniary penalties for breach of the Lender Responsibility Principles

Currently, civil pecuniary penalties, under which monetary penalties are imposed and enforced through non-criminal processes,[81] are unavailable for breaches of the Lender Responsibility Principles.[82] This is an option that is proposed for reform in the 10 October 2018 package.[83]

Under the CCCFA, the courts can order compensation for any loss to borrowers, and issue injunctions, but there are no offences or civil pecuniary penalties. This suggests that there are weak incentives to comply with lender responsibilities. This also affects the incentives for the Commerce Commission to take resource-intensive enforcement action.[84] Civil pecuniary penalties are extensively used in other regulatory regimes, as well as under consumer credit law in Australia.[85]

Financial Services Complaints Ltd (FSCL), an external dispute resolution scheme that receives complaints against financial service providers, noted in its submission to the June 2018 Discussion Paper that there is no detailed guidance on what action is to be taken if there has been a breach of the Lender Responsibility Principles. FSCL usually refers to s 94(1)(b) of CCCFA, which states that a lender should compensate a borrower for the loss or damage resulting from the irresponsible lending.[86] FSCL has interpreted this as meaning that no interest or fees can be charged if there has been irresponsible lending, but the lack of detailed guidelines about this is not very helpful. In its submission, FSCL suggested that it encourage consumers and lenders to accept FSCL's decisions more frequently if they can point to specific legislation or guidance that underpins their views on remedies.[87]

[81] Law Commission *Civil Pecuniary Penalties* (NZLC IP33, 2012) at 8.
[82] Ministry of Business, Innovation and Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 44.
[83] See "Enforcement Option A: Strengthen penalties and enforcement powers for existing obligations" on page 11 of this report.
[84] Ministry of Business, Innovation and Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 44.
[85] National Consumer Credit Protection Act 2009 (Australia Cth), s 167.
[86] Credit Contracts and Consumer Finance Act 2003, s 94(1)(b) refers to an order that the court may make if they engaged in conduct referred to in s 93 of the CCCFA. Section 93(aa) of the CCCFA refers to a breach of s 9C, the Lender Responsibility Principles.
[87] Financial Services Complaints Ltd *Submission on discussion document: Consumer Credit Regulation Review* (Ministry of Business, Innovation & Employment, July 2018) at 7.

c. Difficulties with proving loss

It is also proposed in the 10 October 2018 package that statutory damages be introduced as a penalty for breaches of the Lender Responsibility Principles. Currently, for a breach of the Lender Responsibility Principles, the Commerce Commission must prove loss or damage for affected borrowers. The Commerce Commission must establish for those borrowers:

- That the lender had breached the Principles;
- That the borrower had suffered loss; and
- That the lenders' conduct was an operative cause of the borrower's loss.

If all three requirements are established, the Commerce Commission has to quantify the borrowers' loss. However, in the case of credit contracts, borrowers are likely to have had the benefit of a loan, which makes quantifying their loss difficult. Also, another difficulty with this process is that often a breach of the Lender Responsibility Principles affects multiple borrowers, which in the Commission's view, makes this process difficult and time-consuming, or at worst, prohibitive.[88]

Statutory damages are intended to make it easier for borrowers to claim compensation where the Lender Responsibility Principles are breached. Under the proposals that have been approved by Cabinet in October 2018, where lending has been made in breach of responsible lending requirements, a standard level of statutory damages would be paid equal to the interest and fees that had already been charged. If the amount of statutory damages is less than $200, the amount to be paid would be $200, to ensure there are appropriate consequences. No further interest and fees could be charged on the loan. The court could also order that payment obligations under the credit contract be amended to provide for affordable repayment of the principal amount of the loan.[89]

d. Inconsistent remedial provisions

Under the CCCFA there is no hierarchy of remedies, and, in the view of the Commission, breaches are not treated consistently within the Act.[90] Statutory damages pursuant to s 89 and costs of

[88] Commerce Commission *Commerce Commission submission on Discussion Document: Consumer Credit Regulation* (Ministry of Business, Innovation & Employment, August 2018) at 32.

[89] Refer to page 7 of the Cabinet paper.

[90] Commerce Commission *Commerce Commission submission on Discussion Document: Consumer Credit Regulation* (Ministry of Business, Innovation & Employment, August 2018) at 32, n 39.

borrowing pursuant to s 99(1A) and compensation orders are all available for breaches of s 17 (which requires the lender to disclose as much of the key information as set out in Schedule 1 of the Act as is applicable to the contract before the contract is entered into), and s 22 (which requires the lender to disclose information about a variation to the consumer credit contract if the parties to the contract agree to change the contract). Lenders are required to (in effect) disgorge costs of borrowing for a breach of s 17 (breach of initial disclosure of key information before the contract is entered into listed in Schedule 1) and 22 (disclosure of variations) but they are "infringement" offences subject only to a maximum penalty of $30,000 for a company. A breach of the disclosure standards, however, is an offence with a maximum penalty of $600,000.

By contrast, for disclosure under the CCCFA, there are offences with significant fines (up to $600,000 for a body corporate), infringement offences and statutory damages. In addition, section 99(1A) prohibits lenders in breach of disclosure requirements from collecting interest and fees, which can result in large liabilities.[91]

e. Registration is easy to obtain

There are low regulatory barriers to registration and entry into the credit markets. Currently all lenders are required to be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP (RDR) Act). Registration means that a lender has satisfied certain requirements, including that they are not disqualified under the FSP (RDR) Act and if a licensing enactment requires the person to be a licensed provider, the person is, or will be a licensed provider.[92] Disqualification is a relatively high bar, including not being an undischarged bankrupt, not being prohibited from being a director or promoter of an unincorporated body, not being subject to a management banning order, and not having been convicted in the last five years of crimes involving dishonesty.[93] Registration also requires lenders to be a member of an approved dispute resolution scheme so as to provide consumers access to redress.[94] It has proven resource intensive and difficult in practice to obtain banning orders for lenders and their directors and senior managers. Section 108 of the CCCFA currently enables the District Court to order a person not to provide consumer credit or take part in management of a company providing

[91] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 44.

[92] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 13.

[93] Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 14.

[94] Ministry of Business, Innovation & Employment *Discussion paper: Review of consumer credit regulation* (June 2018) at 18; Financial Service Providers (Registration and Dispute Resolution) Act 2008, s 48.

consumer credit. The order can be made if the person meets criteria, such as having failed more than once to comply with any of the provisions of the CCCFA.[95]

f. Lack of duties for individuals

There is a lack of duties imposed on individuals for breaches of the CCCFA. This is different to other financial markets regimes. For the CCCFA, penalties and other liability sits almost exclusively with the creditor and other body corporates with limited liability. This suggests that duties and incentives on directors and senior managers to comply can be relatively weak – particularly if the lender is small and lightly capitalised. In some cases, penalties and compensation claims can be avoided through voluntary liquidations and the creation of new 'phoenix' companies.[96] Phoenix companies are defined as "companies which are liquidated or otherwise wound up (sometimes to avoid fines or other liabilities), but whose directors and managers then restart it under a new name and FSPR number".[97]

g. Issues with the current injunctive relief

Where lenders have breached the Lender Responsibility Principles, or other provisions of the CCCFA, the Commission can seek an injunction under s 96.[98] However, the wording of this provision restricts the granting of injunctions by the court for only "*restraining* a person from engaging in conduct" [emphasis added] that constitutes, or would constitute a breach of any of the provisions of s 9C, which are the Lender Responsibility Principles.[99] This is not suitable to encourage or ensure ongoing compliance of lenders with their lender responsibilities. The wording of "restraining" conduct cannot require that the lenders undertake particular steps to achieve compliance with the lender responsibilities, only that the lenders do not breach the lender responsibilities, which is already a requirement under the CCCFA.[100]

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[95] Ministry of Business, Innovation & Employment *Discussion paper: Review of consumer credit regulation* (June 2018) at 18.
[96] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 45.
[97] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 5.
[98] Credit Contracts and Consumer Finance Act 2003, s 96.
[99] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 46.
[100] Credit Contracts and Consumer Finance Act 2003, s 9C(1).

Currently, prohibitive injunctive relief is available as a remedy but according to the Commerce Commission, has limitations. The Commission's view is that it does little more than emphasise that lenders must not breach the provisions of the Act. There is limited value in obtaining injunctions that simply particularise the conduct that constitutes a breach of the relevant provisions, particularly where the conduct is already subject to a criminal penalty. By the time the Commerce Commission has ascertained that the lender has engaged in contravening conduct, criminal proceedings are able to be brought. Most lenders cease or change their conduct after the Commerce Commission commences an investigation.[101]

Under the reform package that has been approved by Cabinet, if a lender has breached or is likely to breach the CCCFA, the Commerce Commission would be able to seek injunctions for the purpose of ensuring that the lender is compliant. For example, the court could temporarily prohibit the lender from undertaking further lending, require a lender to obtain and scrutinise bank statements from a borrower before entering into a loan, require a lender to include a warning in advertising of high-cost loans, or require a lender to advise a borrower if lower cost loan types might be available elsewhere.

h. Lack of funding for CCCFA enforcement by the Commerce Commission

Currently enforcement by the Commerce Commission is undertaken under its Crown-funded "Enforcement of General Market Regulation" appropriation - $17.5 million in 2016/17. This is used for administration, education and enforcement of the Commerce Act 1986, the Fair Trading Act 1986, and the CCCFA. From this appropriation, $3.3 million was spent on CCCFA activities in 2016/17. (The costs include CCCFA matters in which there is also an FTA investigation and this activity forms part of the Commerce Commission's general markets and major litigation activity. Historical expenditure includes both direct and overhead costs. Some expenses are fixed, while others are variable costs based on the activity).[102]

There has been a strong call by almost all stakeholders to increase advocacy, monitoring, and enforcement activity by the Commerce Commission. This is expected to reduce irresponsible lending, thereby reducing consumer harm and increasing the competitiveness and efficiency of credit markets.[103]

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[101] Commerce Commission *Commerce Commission submission on Discussion Document: Consumer Credit Regulation* (Ministry of Business, Innovation & Employment, August 2018) at 33.

[102] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 50.

[103] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 50.

Currently all funding for credit regulation is sourced from the Crown (mostly through general taxation), which has been increasing its contribution. Creditors (along with a number of other financial service providers) currently pay an annual levy of $460 (plus GST), which helps to fund the Financial Markets Authority.[104] The Financial Services Federation in its submission to the June 2018 Discussion Paper suggested the levy its member currently pay to the Financial Markets Authority should be paid instead to the Commerce Commission (see further page 45).

It is notable that at present enforcement of the rather nebulous requirements on lenders can be a very expensive process. A simple example is the evidence need in *Commerce Commission v Sportzone Motorcycles Ltd (in liquidation)*[105] for a number of expert witnesses to be called by the Commission on the issue of whether fees charged by a creditor were reasonable. The cost of establishing that a service fee is unreasonable, or that particular conduct was a breach of the responsible lender principles will inevitably be too high to be borne by an individual litigant.

[104] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 51.

[105] *Commerce Commission v Sportzone Motorcycles Ltd (in liquidation)* [2013] NZHC 2531; [2014] 3 NZLR 355; final appeal dismissed *Sportzone Motorcycles Ltd (in liquidation) v Commerce Commission* [2016] NZSC 53; [2016] 1 NZLR 1024.

7. THE VIEWS OF THE COMMERCE COMMISSION ON THE ISSUES AROUND ENFORCEMENT

A range of measures to address non-compliance with the Lender Responsibility Principles was proposed in the June 2018 Discussion Paper. Several of the proposals related to increasing the enforcement powers of the Commission. MBIE's June 2018 proposals that focused on enforcement were:

- Introducing civil pecuniary penalties and statutory damages for beaches of the Lender Responsibility Principles,
- Giving the Commission expanded injunctive powers
- Imposing statutory duties on directors of lenders and possibly senior managers
- Putting obligations on lenders to substantiate their affordability and suitability assessments
- Levying lenders to provide increased funding for the Commission
- Requiring lenders to work with consumer advocates in good faith
- Introducing more prescriptive requirements around affordability assessments and advertising (moving away from principles-based obligations to more clearly defined obligations)
- Requiring disclosure to be in the same language as the advertising.

a. Civil pecuniary penalties

The introduction of civil pecuniary penalties for breaches of lender responsibilities was supported by the Commerce Commission. Pecuniary penalties are available to the Commerce Commission under other legislation and, with reference to other jurisdictions, they are available in Australia for breaches of consumer credit laws. Introducing civil pecuniary penalties would, said the Commission, create efficiencies by reducing the need for the Commission to take criminal and civil proceedings in relation to the same conduct.[106] Introducing civil pecuniary penalties would also mean that the Commission would be able to obtain both compensation and a penalty in one set of proceedings. Civil pecuniary penalties also lend themselves to settlements which create enforcement efficiencies.

Commerce Commission in its submission[107] suggested for the design of the pecuniary penalty regime that

[106] Commerce Commission "Commerce Commission submission on Discussion Document: Consumer Credit Regulation" (1 August 2018) Ministry of Business, Innovation & Employment <www.mbie.govt.nz>.
[107] Page 31.

- The Act specifically provides that statutory damages and orders for compensation take precedence over civil pecuniary penalties where a lender does not have sufficient resources to pay both; and
- That regard is given to which court has jurisdiction to order pecuniary penalties.

Cabinet has approved the introduction of civil pecuniary penalties for breaches of Lender Responsibility Principles

b. Statutory damages

Commerce Commission supported introducing statutory damages for breaches of the Lender Responsibility Principles. This would create efficiencies for the Commission by quantifying amounts payable to affected borrowers without having to establish loss or damage for individual borrowers. It could also (said the Commission) make it easier for individual borrowers or their advocates to take direct action without assistance from the Commission.[108] In the Commission's view, the availability of statutory damages was also likely to provide some general and individual deterrent effect for lenders who breach the Lender Responsibility Principles.[109]

It would in the Commission's view promote efficient enforcement of the CCCFA to provide statutory damages for breaches of the Lender Responsibility Principles but preserve the ability for borrowers (or others) to take action if they have suffered loss or damage above that level. If statutory damages were introduced for breaches of the Lender Responsibility Principles they should be supported by a statutory ability for the Commission to accept enforceable undertakings providing for the payment of an equivalent amount by a lender without the need to obtain a court order to that effect.[110]

Cabinet has approved the introduction of statutory damages.

c. Design of statutory damages

The Commission noted that there is ambiguity about the courts' expected approach to the award of statutory damages.[111] It is not currently clear whether the Commission is required to identify all affected borrowers when seeking orders for statutory damages. The Commerce Commission has brought disclosure prosecutions and in those, the courts have awarded statutory damages

[108] Page 31 of the submission.

[109] Page 31.

[110] Page 32 of the submission.

[111] Page 33 of the submission.

to identified borrowers who received deficient disclosure. The Commission has asked that uncertainties be addressed through specific provisions in the legislation.[112]

d. Mandatory injunctions

The current position is that prohibitive injunctive relief is available as a remedy but has limitations. In the view of the Commission, the current injunctive relief provisions do little more than emphasise that lenders must not breach the provisions of the Act.[113] There is limited value (says the Commission) in obtaining injunctions that simply particularise the conduct that constitutes a breach of the relevant provisions, particularly where the conduct is already subject to a criminal penalty. By the time the Commission has ascertained that the lender has engaged in contravening conduct the Commission is generally able to take criminal proceedings. Most lenders cease or change their conduct after the Commission commences an investigation.

The Commission has suggested that mandatory injunction be available that would enable the Commission to require lenders to take positive steps to comply with the Principles, or to take such other steps as the court considered necessary in the circumstances. For example, it would enable the court to direct that a lender must take such steps as:

- Obtaining and scrutinising bank statements from a borrower before entering into a loan;
- Including a warning in advertising of high-cost loans; or
- Advising a borrower if lower cost loan types might be elsewhere available.

Injunctions or orders of this nature as available to ASIC in Australia. Section 177 of the National Consumer Credit Protection Act 2009 gives the Court powers to require a person act on such terms as the Court thinks is appropriate.

Mandatory injunctive powers for the Commission have been approved by Cabinet.

e. Stop orders/warning letters

MBIE's Additional Information Document asked for feedback on whether stop and direction orders would be a useful enforcement tool. Commerce Commission did not think Stop and Direction orders are necessary as enforcement tools.[114] In this context the Commission said that currently if a lender is engaging in conduct that the Commission considers breaches the CCCFA, and thinks that the conduct needs to cease in order to prevent further consumer harm, a "stop now" letter will be sent. These letters serve as a letter before action seeking an injunction and

[112] Page 33.
[113] ComCom submission page 33.
[114] Submission page 34.

outline the Commerce Commission's concerns and request that the lender stops the relevant conduct. These letters have, according to the Commission, mostly proven effective. If a lender refused to comply with the Commission's request, an injunction can be sought.

f. Directors' duties

The Commission saw the issue of whether directors should have statutory duties relating to the lender's compliance with the CCCFA as a matter of policy on which it was reluctant to comment. The Commission did have some suggestions for the design of directors' duties if they were adopted. It did note that enforcing these duties would have resourcing implications.

Imposing duties on directors and senior managers has been approved by Cabinet.

g. Substantiation obligations for lenders (Lender Responsibility Principles)

The Commission strongly supported the introduction of an offence of a failure to substantiate an appropriate loan affordability and suitability assessment, saying it would assist with enforcement of the Lender Responsibility Principles.[115] An offence would make it easier to take enforcement action against lenders who cannot produce evidence of their affordability assessments - particularly those who have not made any inquiries about a borrower's' ability to repay the loan - without any need to prove:

- Whether the lender has made inquiries and whether they are reasonable; and
- Whether the lender could have been reasonably satisfied that the borrower could make payments.

In the Commission's view this also would assist borrowers to take their own action. Currently, (says the Commission) borrowers and their advocates find it difficult to obtain information from lenders about what inquiries and assessments were made. If lenders are not able, on request, to provide evidence that they have made reasonable inquiries and how they have assessed all the information available to them then this option would allow borrowers to take their own action in the Disputes Tribunal.

Cabinet has approved the introduction of substantiation obligations on lenders, which means lenders must substantiate their affordability and suitability assessments and supply a copy on request. This is will require lenders to be able to proactively demonstrate that they are complying with statutory requirements. There will be civil penalties for lenders that fail to do this.

[115] Submission page 36.

h. Increased industry levy on creditors

One proposal put up in the June 2018 Discussion Paper was that there would be a levy on lenders to help fund the increased regulatory activity by the Commerce Commission. The Commission supported this, noting that the current registration levy on lenders who provide credit under credit contracts is paid to the FMA.

This proposal has not been recommended by MBIE or approved by Cabinet.

i. Lenders to work with consumer advocates if asked to do so and in good faith

The Commission supported having a statutory obligation for lenders to have to work with consumer advocates in good faith.[116] This proposal has not been recommended by MBIE or approved by Cabinet.

j. More prescriptive requirements for conducting affordability assessments

Under this proposal, mandatory requirements would be introduced for some types of lenders and loans to assess affordability in accordance with a defined procedure, for example around assessing the borrower's uncommitted income. It was also proposed that the current provision allowing a lender to rely on the information provided by the borrower (unless the lender has reasonable grounds to believe the information to be unreliable) be removed.

The Commission's view of these proposals was that it strongly supported the introduction of more prescription around affordability assessments. [117] The Commission considered it was possible to set minimum prescriptive requirements without compromising the lenders' need for flexibility. The Commission also supported the need for lenders to have to verify the information provided by borrowers.[118]

Both of these proposals have been approved by Cabinet.

k. More prescriptive requirements for advertising

The June 2018 Discussion Paper asked for views on whether changes to the current rules around advertising were necessary. The Commission's view was that the current provisions of the Lender

[116] Submission page 37.

[117] Submission page 39.

[118] Submission page 40.

Responsibility Principles relating to advertising were not sufficiently prescriptive. The proposal to have more prescriptive requirements for advertising have been approved by Cabinet.

l. Disclosure to be in same language as advertising

This proposal was supported by the Commission and has been recommended by MBIE and approved by Cabinet.

8. THE VIEWS OF OTHER SUBMITTERS TO THE JUNE 2018 DISCUSSION DOCUMENT ON HOW TO IMPROVE ENFORCEMENT OF THE CCCFA

Enforcement issues were discussed in many of the submissions to the June 2018 Discussion Paper. Many of the lenders suggested that rather than introduce more prescription in the law, the problems with irresponsible lending could be addressed by more and especially more targeted enforcement. Other submitters had specific suggestions as to how the current rules could be more effectively enforced.

Particular suggestions that were made by submitters included that:

- all high cost lenders be regularly audited by the Commerce Commission (and the Commission have a statutory obligation to undertake these regular audits),
- an Australian-type rebuttable presumption be introduced (ie if the borrower is in default on another high cost loan, then that raises a presumption that the borrower will not be make the payments under the agreement without suffering substantial hardship),
- there be a national database of high cost loans so that lenders can access information on borrowers' history with high cost loans,
- each lender should have to have a designated compliance officer, being a person whose role it was to ensure that the lender responsibility obligations were complied with,
- there should be a "red flag" system in the law relating to borrowers and those borrowers that raise a certain number of red flags should be required to consult a financial mentor before taking out a high cost loan and additional inquiries to assess affordability would have to be made.

Suggestions around enforcement made by submitters:[119]

A. The lenders and lender bodies

Moola - High Cost Lender

Moola suggested that there should be a requirement for regular audits of all high cost lenders by the Commerce Commission every 6 or 12 months, funded by lenders to ensure compliance with the CCCFA.

Sunshine Loans - Australian high cost lender looking to set up in NZ

Sunshine Loans suggested New Zealand introduce the rebuttable presumption system like Australia has. In Australia, the loan is presumed to be unsuitable if the borrower is in default on another high cost short term loan or if they have held two other such loans in the last 90 days.

DCO Finance - May be just below the threshold for a high cost lender[120]

DCO Finance suggested that there needs to be more prescription around affordability assessments to get around the problem of borrowers overstating income and understating expenses in their desperation for a loan. Personal Property Securities and Comprehensive Credit Reporting regimes already operate registers, a similar register for high cost loans would help lenders to assess affordability and others to gather information on borrowers' use of high cost loans.

DCO also suggested that lenders should have a designated compliance officer who is familiar with the CCCFA, this is like the Anti-Money Laundering and Countering Financing of Terrorism Act

[119] A summary of the key points made by submitters is included in the Appendix. Submissions are accessible from: https://www.mbie.govt.nz/document-library/search?keywords=consumer+credit+regulation+review&df=01%2F05%2F2018&dt=31%2F12%2F2018&submit=Search&type%5B66%5D=66&topic%5B3%5D=3&subtopic%5B19%5D=19&sort=

[120] 'High cost' is commonly understood to mean (in a New Zealand context) an interest rate of or above 50% per annum. The Responsible Lending Code treats as treats as high-cost credit agreements those agreements where the annual interest rate (expressed in terms of a percentage) is 50% or greater, and this definition was used in MBIE's review – see "Additional Information to Support the Discussion Paper", June 2018, 5, (Additional Information Document) accessible at: https://www.mbie.govt.nz/assets/3f19e04173/background-and-technical-detail-for-discussion-paper.pdf

2009,[121] which is a good system. For that Act, a risk assessment and programme must be completed and audited every two years.[122]

<u>Acorn Finance - May be just below the high cost lender threshold</u>

Acorn Finance suggested that national register of loans is needed so the lender can find out about the borrower's situation.

Acorn Finance was against an increased industry levy because good lenders would be subsidizing the costs of enforcement against bad lenders.

Acorn Finance prefer arbitration mechanisms (e.g. dispute resolution schemes) to court involvement.

<u>Rapid Loans - May be just below the high cost lender threshold</u>

Rapid Loans also supported the idea that there should be a national database so that the lender could find out whether the borrower has a loan with another lender.[123]

Rapid Loans supported the Australian "rebuttable presumption" approach if borrower has previously defaulted.

Rapid Loans were not against more prescription around affordability assessment, and suggested that the model should be based off good industry practice, such as 60 days of bank statements and that the lender must seek verification if there is a conflict in the financial information provided. Bank statements are the appropriate verification source. This lender suggested using the Australian model of 90 days of bank statements.

In the view of this lender, there is no point in increasing penalties if there is no threat of getting caught. There is no obvious benefit in Australia to licensing of lenders, this just increases compliance costs. The Australian model has civil pecuniary penalties, but this has had limited success.

<u>ANZ Bank</u>

[121] Anti-Money Laundering and Counter Financing of Terrorism Act 2009, s 52.
[122] Anti-Money Laundering and Counter Financing of Terrorism Act 2009, s 59.
[123] Some states in the USA operate national databases of payday loans including Oklahoma.

ANZ suggested that enforceable undertaking regime should be included in the CCCFA, similar to the regime included in the Fair Trading Act.[124] Under this regime, the regulator could require creditors to take specific actions to correct or avoid breaching the CCCFA. This would allow greater flexibility for the regulator to take swift corrective action, without needing to meet the higher thresholds of evidence or harm required if proceedings were filed. It would also allow creditors to take remedial action without admitting guilt or liability for a breach, with certainty as to outcome.

To address irresponsible lending, ANZ suggested that all creditors should have to report loans into a comprehensive credit reporting system. This would help borrowers improve their credit score, helps regulator monitor and review lenders, helps lenders identify vulnerable borrowers and to make credit decisions.

BNZ Bank

BNZ was against more prescription around affordability assessment, but said more guidance was welcome (i.e. amend the Code to give more guidance). BNZ was against any amendment to s 9C(7) (the provision that allows a lender to lender rely on information provided by the borrower unless the lender has reasonable grounds to believe the information is not reliable). BNZ was not in support of pecuniary penalties etc because the law is principles-based. BNZ was also against substantiation obligations around affordability and suitability.

ASB Bank

ASB Bank supported an industry levy and requiring the lender to work with consumer advocates.

Thorn Group Financial Services

Thorn Group Financial Services was generally against any increased compliance obligations on lenders, saying that more compliance costs will result in borrowing becoming more expensive generally. Smaller and alternative providers will likely leave the market due to costs. For example, the obligation to substantiate affordability assessments and provide a copy, the Commission can already enforce this.

Financial Services Federation (industry body for lenders)

[124] Fair Trading Act 1986, ss 46A and 46B.

FSF was very against substantiation obligations as they are of the opinion that financial mentors and social agencies (who are asking for them) only see the people who are in difficult circumstances due to irresponsible lending, so would therefore think that superficial affordability assessments was the norm.

The FSF submission reported that FSF members are already paying a levy to the FMA on the basis that they took the view they were financial advisers so have been paying a levy under the Financial Advisers Act. However the Financial Services Legislation Amendment Bill will change this by making clear that consumer credit contract and credit-related insurance providers are exempted from coverage of financial adviser legislation because they would be covered by the CCCFA. FSF suggested that once that is clarified, the levy should be paid to the Commerce Commission and that it should be paid by all lenders.

FSF considered that enforcement should be better resourced so that the Commission can enforce the law. Not only should there be people to investigate instances of irresponsible lending, but there should also be measures to permanently put predatory lenders out of business. With better resources, the Commission would be able to act quickly against irresponsible lenders, which would also provide a necessary deterrent to other lenders. More resources should be put into ensuring that financial mentors can provide a quality service and financial training, i.e. resourcing of financial literacy initiatives.

FSF was very against any change to 9C(7) regarding lenders relying on information provided by borrowers. Any change to this will burden responsible lenders with the costs that should be borne by irresponsible lenders.

NZ Bankers' Association

The NZBA considered that enforcement of the Lender Responsibility Principles is a problem as a principles-based system is inherently subjective. Penalties would not be able to be applied to principles. The standards are not black and white.

B. Dispute Resolution Schemes

Financial Services Complaints Ltd

FSCL were of the view that it should be mandatory for the lender to have to refer the borrower to the dispute resolution scheme if the loan is defaulted on in the first three months of the loan being advanced. This is because default within such a short period of time after the loan is granted means there is a higher likelihood the customer could never afford the loan and the lender may have breached its responsible lending obligations. Also, it should be mandatory for lenders to give borrowers details of the scheme if any complaint is made.

In relation to lenders' obligations to consider borrowers' applications for leniency on the grounds of hardship (see ss 55 and 56 of the CCCFA), FSCL has produced a best practice guide for assessing financial hardship applications, in 2017, for their scheme members. There were inconsistencies in how lenders were complying with the CCCFA timelines for assessing applications and in the information they were gathering from borrowers to assess applications.

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

Although FSCL does not 'penalise' lenders if there have been instances of irresponsible lending, the fact that CCCFA does not give absolute guidance on what action is to be taken if there is a breach, makes it difficult for FSCL in making a decision about the remedies available after a breach. FSCL usually refers to s 94(1)(b) of CCCFA which states that a lender should compensate a borrower for the loss or damage resulting from the irresponsible lending. FSCL has interpreted this as meaning that no interest or fees can be charged if there has been irresponsible lending. However, FSCL notes that it would be helpful if there were more detailed guidelines around this.

It may also encourage consumers and lenders to accept FSCL's decisions more frequently if they can point to actual legislation or guidance that underpins FSCL's views on remedies.

FSCL strongly submitted it should be mandatory for lenders to give borrowers the details of the lender's dispute resolution scheme at the time a complaint about any issue is made. It should also be mandatory for lenders to notify clients not only of the ability to apply to court if they do not agree with the lender's decision on an application to vary the credit contract on the grounds of unforeseen hardship, but also of the ability to contact the lender's dispute resolution scheme. This would necessitate an amendment to s 58 of the CCCFA.

C. Financial Mentors and Consumer Organisations

Levin Budget Services

Levin Budget Services suggested that borrowers should have to go to a financial mentor before being lent to, at least if the borrower's income is below a certain income level. In particular, it should not be legal to lend to people on a benefit.

Citizens' Advice Bureau

In the view of the Citizen's Advice Bureau, a major concern is the lack of incentives to comply with the law, which means there needs to be more enforcement. There should be a penalties regime that gives a strong incentive to comply. Clients have difficulties with following up on non-compliance, so monitoring and enforcement should be done by someone else, namely the Commerce Commission.

Christians Against Poverty

Christians Against Poverty suggested that the Code should be binding and changed to a rules-based approach instead of principles-based (this suggestion was also repeated by CBNZ Inc (Christian Budgeting and Christchurch Budget Services).

Waahi Whaanui Trust (Huntly)

Waahi Whaanui Trust (Huntly) suggested that there should be a system where borrowers who report non-compliant advertising receive a financial bonus paid by the lender if the lender is found to be in breach.

This Trust also suggests that more funding should be put into resourcing for advocacy for consumers to reduce harm caused, e.g. for FinCap. Enforcement should not just be left to the Commission, consumer advocates should get more funding so they can negotiate a settlement with the lender or take the matter to the dispute resolution scheme. The Trust suggested that penalties levied against lenders should be paid to the advocates.

Full Balance Financial Coaching and Consulting - Financial Consultant

In order to strengthen enforcement of lenders conducting comprehensive affordability assessments before issuing a loan, Full Balance suggested that there should be two tiers of affordability assessment. Lenders should not be able to rely on what the borrower says, as borrowers who are desperate for a loan will lie about other borrowing. Borrowers need easy routes to enforcement as lenders currently know that they can get away with non-compliance. A system of "red flags of hardship" was suggested to prompt the lender to undertake a second level of affordability assessment in appropriate cases. These red flags are signs that a borrower is struggling with their finances, which would require the lender to gather more information about the borrower's circumstances. If any red flag was present, then the lender would have more obligations around affordability assessment.

The red flags that the borrower may be under financial stress are:

1. They are using the debt to pay for essential bills, such as power, rent, debt arrears;
2. They live up to the limit of their overdrafts and/or their credit cards are maxed out;
3. They are consolidating debt, because they are having difficulty keeping up with the debt they already have;
4. They are on a low income relative to the number of dependents, and are relying on government support to get by;
5. The amount they spend on food relative to the number of people they are supporting is minimal ($60 - $100/week/adult is normal);
6. They are not able to put any money aside for savings, or redrawing back straight away the savings; and
7. There is minimal discretionary spending showing on their bank account, and it is mainly bills, food and petrol.

D. Micro finance providers

Ngā Tangata Microfinance

Ngā Tangata Microfinance suggested that more proactive enforcement is required, especially regular audits of lenders. Proven non-compliance with the Lender Responsibility Principles should result in the loan being written off.

E. Other

Human Rights Commission

The Human Rights Commission suggested that a human rights approach to consumer credit would see the contract being unenforceable in law if at the time of the contract was made it would render the borrower unable to meet their basic needs.

Association of NZ Advertisers

Association of NZ Advertisers were of the view that responsible credit providers should not be burdened with additional compliance to solve problems created by a small percentage of lenders (i.e. loan sharks and mobile traders).

Auckland Regional Public Health

Auckland Regional Public Health noted that Australia has introduced more prescriptive affordability assessment, as principles-based approach did not bring about sufficient change.

Rob Dowler

An individual submitter, Rob Dowler, also suggested that in cases of default by borrower the matter be automatically referred to a dispute resolution scheme. If they find irresponsible lending the loan must be reduced or written off. In his view this would be better than waiting for the Commission to identify a problem at the systemic level.

9. PROPOSALS FOR REFORM OF THE CCCFA IN THE 10 OCTOBER 2018 PACKAGE

The proposals for reform of the CCCFA in relation to enforcement include reforms to address irresponsible lending and reforms to address non-compliance with the law. This section outlines the reforms that have been approved by Cabinet. This information is taken from MBIE's Impact Statement Consumer Credit Regulation Review, available from https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-credit-law/review-of-consumer-credit-law-2018/

i. Registration reforms

Two out of three proposed options for registration reforms have been approved by Cabinet. The third option that was in the June discussion paper (which is the option not accepted) was a comprehensive creditor licensing regime. The reasons why this has been rejected are outlined in MBIE's Regulatory Impact Statement.[125]

The recommended reforms around registration:

Irresponsible lending *(pp.17-22)*	Registration Option A: Simplify process to ban directors from involvement in the credit industry	**Benefits:** Enables more effective and streamlined banning, which deters irresponsible lending. **Costs:** Increased monitoring and enforcement. **Risks and limitations:** More lenders may operate underground.
	Registration Option B: Introduce a fit and proper person test in registration of lenders	**Benefits:** Reduces participation of individuals with a history of misconduct/non-compliance. Reduces irresponsible lending. **Costs:** Lender registration fees and administrative costs for government. **Risks and limitations:** May reduce competition and consumer choice in credit providers.

Registration Option A: Expanded powers to deregister lenders and ban directors from future involvement in the credit industry.

Only part of this option will be adopted for reform, which is to improve the ability of the Commerce Commission to ban directors and senior managers of lenders which have contravened the Act, from future involvement in the industry.

[125] Commerce Commission *Enforcement Response Guidelines* (October 2018) at 24.

The part of the option that is adopted for reform is:

- *Simplifying CCCFA banning orders*. It is noted by MBIE that the current threshold for obtaining a banning order against a director or senior manager of a lender may be too high. This is particularly so where the individual has not been shown to have personally breached the Act. Generally only the creditor (body corporate) is charged with an offence or a party to civil proceedings, but in practice it is directors and senior managers who are responsible for ensuring that the business complies.

- S 108 would be amended so that misconduct which makes a person eligible for a banning order is expanded, including offences against CCCFA, FTA, ss 217- 265 Crimes Act (relating to crimes against property), the Financial Service Providers (Registration and Dispute Resolution) Act and the Secondhand Dealers and Pawnbrokers Act, or any equivalent overseas legislation. Also expanded to include situations where civil pecuniary penalties are incurred or directors' duties breached. Additionally, provision that may prevent a banning order from being given if the person has no previous convictions (section 108(1A)(a)(ii)) would be deleted to enable orders to be obtained more efficiently.

The banning order component of this option is said to enable more effective and streamlined banning and removal of people from the lending industry. It is predicted that this would lead to a modest reduction in irresponsible lending over time, and a consequent reduction in consumer harm. It also may result in lenders taking risk averse approach to lending.

It is noted that part of this option, which was expanding the Commerce Commission's powers to include directing permanent deregistration of lenders and banning of individuals involved in those creditors, has not been recommended.

<u>Registration Option B: Introduce fit and proper person test in registration of lenders</u>

This option requires directors and senior managers of consumer credit providers to show they are fit and proper persons, in addition to the existing registration process on the FSPR. The implications of this is that businesses, which are led by individuals who are at a higher risk of engaging in irresponsible lending, would be prevented from acting as lenders in the first instance, rather than waiting for a breach of law before considering their ongoing fitness to lend.

The fit and proper person test would cover good character and capability assessments, which requires the regulator to do some research and investigation. Periodic reassessment or reconfirmation of individuals' good character to ensure ongoing compliance. If a creditor's

directors and senior managers are no longer fit and proper persons, processes for removing their registration will be provided for. The decision would also be subject to appeal.

- Average cost: For an average lender with four directors/senior managers, the approximate total upfront cost of the fit and proper person test to a lender could be around $5,200. As the processes and administration involved in the periodic re-assessment or re-confirmation would be lower than the initial assessment, re-assessment or re-confirmation costs/fees would also be lower.

The fit and proper person test could reduce the participation in the credit markets of individuals who have a history of misconduct, dishonesty or involvement in businesses that show a lack of regard for compliance.

This option imposes moderate direct costs on some lenders (from higher registration fees) and also indirect administrative costs, with the process for a lender appointing new directors or senior managers also becoming more onerous. Lenders may pass the additional compliance costs onto consumers in some form e.g. higher interest rates or fees.

j. Non-compliant lending reforms

MBIE has identified two specific areas of significant non-compliance, which are:

- Carrying out affordability assessments; and
- Advertising practices

Lenders do not appear to be complying with responsible lending requirements. MBIE’s desk-based study of lenders also found that a significant number of websites and advertising by lenders do not display the required information. When lenders do not comply with their legal obligations to lend responsibly, there is a greater risk of harm to borrowers.

The underlying cause of non-compliance may be a lack of clarity or understanding on the part of a lender about their CCCFA obligations. Another underlying cause of non-compliance is that there are relatively weak incentives for lenders to comply with some CCCFA obligations.

The following reforms have been approved by Cabinet:

Enforcement Option A: Strengthen penalties and enforcement powers for existing obligations

Civil pecuniary penalties

- These provide stronger incentives for creditors to comply with the Lender Responsibility Principles. They also help address problem of non-compliance by providing a greater deterrent for lenders and greater incentive for the regulator to take enforcement action.

Statutory damages

- These make it easier for borrowers to claim compensation where Lender Responsibility Principles have been breached. Greater incentive for lenders to comply with the requirements. Standard level of statutory damages would be paid equal to the interest and fees that had already been charged. Min amount to be paid $200 to ensure there are appropriate consequences (if amount of statutory damages is less than $200). No further interest and fees could be charged on the loan. The court could also order that payment obligations under the credit contract be amended to provide for affordable repayment of the principal amount of the loan.

Expanded injunctive relief

- If the lender is likely to breach/has breached CCCFA, the Commission is able to seek injunctions to ensure lender is compliant. E.g. The court could temporarily prohibit the lender from undertaking further lending, require the lender to obtain and scrutinise bank statements from borrowers before entering into a loan, require lenders to include warning in advertising of high-cost loans, or require lender to advise a borrower if lower cost loan types might be available elsewhere.

These proposals would have minimal costs, the most significant of which will be indirect compliance costs on lenders, which may be incurred to bring them up to existing expectations so that they avoid incurring penalties. The expected Effectiveness of this proposal in increasing confidence in consumer credit markets depends on enforcement action being taken to send a signal to the industry that there is a real threat of significant financial penalties. Furthermore, more serious penalties for a breach of responsible lending are possibly best implemented alongside clearer legal obligations, which could take the form of more prescriptive requirements for fulfilling those responsibilities.

Enforcement Option B: Duties for directors and senior managers

Subject directors and senior managers to duties of due diligence to ensure that the creditor complies with its CCCFA obligations.

Directors could fulfil their duties by ensuring that the creditor has adequate policies for compliance with the CCCFA, and adequate systems for implementing those policies and detecting breaches.

Senior managers would also have duties because they have direct oversight of lending decisions and other day-to-day operations. Senior managers, and directors with more direct involvement in the day-to-day management of the creditor, would fulfil their duties by implementing appropriate systems themselves, ensuring that staff are adequately trained, regularly checking compliance, and taking corrective action where necessary.

Duties of due diligence would be similar to directors' duties in other legislation, also relevant case law may be applicable.

This is intended to reduce the ability of non-compliant creditors to 'regenerate' as new creditors, with the same directors in place (phoenix companies). Duties placed on senior managers, meanwhile, would target duties at persons whose position allows them to exercise significant influence over the management or administration of the creditor.

Due diligence regarding responsible lending and broader compliance with CCCFA is appropriate, and should be a matter of course for responsible lenders. Duties will have an impact on making directors and senior managers take more notice of the creditor's compliance obligations, and support a compliance culture. This option is likely to slightly reduce non-compliance and therefore have a small impact in protecting consumers from irresponsible lending.

Enforcement Option C: Substantiation obligation for lenders

This would require lenders to substantiate their affordability and suitability assessments, and supply a copy on request to the borrower (or their agent) or the Commerce Commission. Requires lenders to document their assessment processes and the evidence relied upon, and would put the burden on lenders to proactively demonstrate that they are conducting all the necessary inquiries.

Lenders could be required to provide the substantiation within a reasonable timeframe such as 10 working days. Where responsible lenders carry out the assessments anyway, identifying and providing this evidence should not take an unreasonable amount of time.

Keeping records of assessments is a responsible practice as it substantiates a borrower's ability to meet the loan repayments and obligations and indicates that the lender has carried out an assessment of the suitability/affordability of the loan for the borrower.

Requests for substantiation documents are likely to be low, only when there is a need for proving that the assessments took place. Expected that most responsible and compliant lenders already document these assessments and that as a result the costs of keeping such records will fall on irresponsible lenders for whom documenting this information should be a focus for ensuring their own compliance and the rights of borrowers are met.

Responsibility Option A: Prescriptive requirements for affordability and suitability

Mandatory minimum standards would be introduced for some or all types of lenders and loans to assess affordability and suitability of loans in accordance with a defined procedure. Lenders would be required to calculate a borrower's uncommitted income, which would be based on information verified by a review of bank statements and other documentation. This would address the lack of clarity about how to comply with the principles-based legislation.

A key benefit is that clearer legal obligations are likely to make non-compliance easier to identify and prove, and therefore make enforcement easier. Non-compliance is likely to decrease to some extent, with the flow-on effect of more consumers being protected from irresponsible lending.

Stakeholders' view: Most consumer advocates, consumers and the Commerce Commission supported more prescriptive affordability assessments. Many submitters thought that minimum standards should apply to all types of lenders and loans. However, different types of loans would need different levels of affordability assessments. Arguably prescriptive requirements are likely to make non-compliant lenders take more notice of their legal obligations rather than the lenders not complying with the RLC.

Responsibility Option B: Limit ability of lenders to rely on information provided by the borrower

Currently s 9C(7) permits the lender to rely on information provided by the borrower for affordability assessments unless they have reasonable grounds to believe the information is not reliable. The threshold of "reasonable grounds" is high, and in practice this means that lenders are permitted to accept borrower statements about income and expenses at face value, unless they are inconsistent with other information the lender holds about the borrower, or are

unrealistic. This is likely to be a barrier to requiring lenders to undertake reasonable inquiries to assess the affordability of repayments.

This option would remove this option, so lenders would need to obtain more objective verification of key borrower information, where it was warranted as part of undertaking “reasonable inquiries”. E.g. Lenders may need to obtain payslips or bank account transactions to verify income and fixed financial commitments, given that this is among the most important borrower information.

This reform may increase compliance with lenders that are not currently compliant, by removing a provision that makes expectations around verifying information unclear.

Responsibility Option C: Prescriptive requirements for responsible lending

Current RLC guidance for advertising would be made binding, with any necessary or desirable modifications. A key feature would be making it mandatory for high-cost lenders to include a warning about high-cost credit, and for lenders to advertise their annual interest rate. The requirements would also specifically address direct marketing to borrowers. The technical detail of this would be prescribed through regulations, with a new regulation-making power created in the Act to empower them.

There may be some changes to some systems and processes of compliant lenders to give them greater confidence about their ongoing compliance with the advertising requirements.

Responsibility Option D: Require disclosure to be in the same language as advertising

Mandatory requirement that disclosure statements be provided in the language that the borrower is most comfortable communicating in, if the lender advertised in that language. This change would aim to assist borrowers in making an informed decision.

Need to clearly distinguish what constitutes promotional material in another language, to avoid capturing support material from a community organisation providing financial support or translations in other languages.

This option makes legal obligations clearer, which is likely to increase compliance and make enforcement easier. It would help to ensure that the level of assistance received by vulnerable consumers would at least match that of other consumers, and support more informed decision-

making. It reduces incentives for predatory lending that is targeted at vulnerable consumers who may not understand contractual terms.

Non-compliance ***(pp.23-34)***	Enforcement Option A: strengthen penalties and enforcement powers for existing obligations	**Benefits:** Increased ease of prosecution and deterrence. **Costs:** Lenders may be more risk averse, raising compliance costs. **Risks and limitations:** N/A
	Enforcement Option B: duty of due diligence for directors and senior managers	**Benefits:** Incentives for directors to ensure adequate compliance systems. Makes enforcement easier. **Costs:** Enforcement costs for Commerce Commission. **Risks and limitations:** May leave room for differing interpretations of obligations.
	Enforcement Option C: substantiation obligation for lenders	**Benefits:** Makes consumer self-enforcement and Commerce Commission action easier. **Costs:** Compliance costs for any lenders who are not already documenting their processes. **Risks and limitations:** N/A
	Responsibility Option A: prescriptive requirements for affordability (established in regulations)	**Benefits:** Improves clarity of law, which potentially improves compliance. Makes enforcement easier. **Costs:** Compliance costs for lenders. **Risks and limitations:** Limits access to credit for some borrowers. Does not address wilful non-compliance.
	Responsibility Option B: limit the ability of lenders to rely on information provided by the borrower	**Benefits:** Strengthens affordability assessments. Makes enforcement action easier. **Costs:** Slight increase in costs for currently irresponsible lenders. **Risks and limitations:** May deter some consumers from applying for credit.
	Responsibility Option C: prescriptive requirements for responsible advertising	**Benefits:** Clarifies expectations around responsible advertising. Makes enforcement easier. **Costs:** Initial system set-up costs. **Risks and limitations:** May not change the behaviour of desperate and vulnerable borrowers.
	Responsibility Option D: require disclosure to be in the same language as advertising	**Benefits:** Improves information disclosure to vulnerable consumers. Reduces predatory lending targeted at vulnerable consumers. **Costs:** Costs for lenders who already advertise in multiple languages. **Risks and limitations:** Lenders may stop advertising in

10. INFRINGEMENT OFFENCES AS A REGULATORY TOOL

One regulatory tool used in the CCCFA and various other statutes is to give the regulator the ability to issue infringement notices for breaches of specific statutory obligations. This could potentially be a way for the Commerce Commission to more easily enforce the Lender Responsibility Principles, provided that there is more detailed prescription in the law reform as to how a lender is to comply with the principles. Infringement offence notices, also known as instant fines, are generally used to deal with minor criminal matters in a way that is convenient for prosecuting authorities and defendants, i.e. outside the court system. They do not result in criminal convictions nor a term of imprisonment. Infringement offences are in place to deter conduct that is of a relatively low seriousness and does not justify the full imposition of the criminal law. Penalties for infringement offences should generally be less than $1,000.[126]

According to legislation guidelines, infringement penalties may be appropriate if:[127]

- The conduct represents a minor contravention of the law;
- Large numbers of strict or absolute liability offences are committed in high volumes on a regular basis;
- The conduct involves straightforward issues of fact that can be easily identified by an enforcement officer;
- A fixed penalty can achieve a proportionate deterrent effect because contraventions of the particular prohibition are reasonably uniform in nature (if individual culpability can vary widely, the conduct is unlikely to be suitable to be dealt with by infringement offence); or
- Identifying actual offenders is not practicable (for instance, in relation to parking, speed cameras, or toll road offences), but liability may be attributed to the person who has prima facie responsibility for the item used in the offending (such as the owner of the vehicle that is found speeding or illegally parked).[128]

The purpose of an infringement scheme is to:

- Achieve compliance with the law and to reduce the harm caused by minor offending;
- Hold people accountable for their actions and to promote a sense of responsibility, and

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[126] Legislation Design and Advisory Committee *Legislation Guidelines* (May 2018) at 118.
http://www.ldac.org.nz/guidelines/legislation-guidelines-2018-edition/compliance-and-enforcement/chapter-25/

[127] Legislation Design and Advisory Committee *Legislation Guidelines* (May 2018) at 118.
http://www.ldac.org.nz/guidelines/legislation-guidelines-2018-edition/compliance-and-enforcement/chapter-25/

[128] Legislation Design and Advisory Committee *Legislation Guidelines* (May 2018) at 118.
http://www.ldac.org.nz/guidelines/legislation-guidelines-2018-edition/compliance-and-enforcement/chapter-25/

- Educate people about unacceptable conduct and its inherent social harm.[129]

Even though infringement notices deal with minor offending, the monetary penalties can be significant.[130] However, infringement offences have been criticised as a '"one-size-fits-all" approach that does not allow for consideration to be given to the circumstances of the offence or of the defendant.[131] Also, what constitutes minor offending is difficult to define, but offending may be considered minor because of the level of penalty it attracts, or the degree of harm resulting, or because it is considered not to be as morally reprehensible as other forms of offending.[132] Attached as **Appendix 1** is an academic view on the use of infringement offences.

a. The Legal Framework for Infringement Offences

Section 21 of the Summary Proceedings Act 1957 (SPA) governs the procedure for infringement offences. An offence should have an express provision that it is an infringement offence. Section 2 of the SPA also lists the sections under which infringement notices can be issued, but it is not an exhaustive list as it includes "any provision of any other Act providing for the use of the infringement notice procedure".[133]

The primary legislation which gives authority for an infringement notice to be issued sets the maximum penalty level, the form that infringement notices must be issued in, identifies who can issue infringement notices and who is entitled to the infringement fees collected. Under the primary legislation, regulations, rules and bylaws are also made to govern the details of the specific infringement offence, which include the form of the infringement notice and reminder notice to be issued, the specific act or omission constituting an infringement offence and the specific penalty levels for each infringement offence.[134]

b. Infringement Offences in Legislation

Acts listed in s 2 of the SPA which use infringement offences include the Companies Act 1993 (s 207Z), the Financial Markets Conduct Act 2013 (s 514) and the Fair Trading Act 1986 (s 40D).

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[129] Ministry of Justice *Policy Framework for New Infringement Schemes* at 1.

[130] David Wilson "Instant Fines: Instant Justice? The use of infringement offence notices in New Zealand" (December 2001) 17 Social Policy Journal of New Zealand 72 at 72. https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/journals-and-magazines/social-policy-journal/spj17/17_pages72_81.pdf

[131] Law Commission "Law Commission proposes overhaul of infringement system" (press release, 30 August 2005). https://www.lawcom.govt.nz/sites/default/files/mediaReleaseAttachments/Publication_117_320_PR%20INF.pdf

[132] Law Commission *The Infringement System: A Framework for Reform* (NZLC SP16, 2005) at 14. https://lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20SP16.pdf

[133] Summary Proceeding Act 1957, s 2 definition of "infringement notice" (k).

[134] Ministry of Justice *Policy Framework for New Infringement Schemes* at 2.

Infringement offences in the Companies Act 1993 are governed by ss 207X - s 207ZB. The infringement fee for breaching an infringement offence is $7,000 and is imposed not on the company, but directly on the offending director.[135] The offences that allow infringement notices to be issued for breaches are financial reporting offences, where financial statements are not completed and signed within a specific time, or they fail to comply with an applicable financial reporting standard.[136]

Infringement offences in the Financial Markets Conduct Act 2013 are governed by ss 513 - 516. The Financial Markets Authority may issue an infringement notice to a person if they believe on reasonable grounds that the person is committing, or has committed, an infringement offence.[137]

In the Fair Trading Act 1986, ss 40B - 40H govern infringement offences. The maximum infringement fee that can be imposed is $2,000.[138] The Commission may issue an infringement notice to a person if they believe on reasonable grounds that the person is committing, or has committed, an infringement offence; and no information for that offence has been laid against, and no infringement notice has been issued to, the person in relation to the conduct alleged to be an infringement offence.[139]

c. Infringement Offences and the CCCFA

Breaches of disclosure provisions under the CCCFA, give rise to offences with significant fines, infringement offences and statutory damages.[140] The maximum infringement fee for committing an infringement offence under the CCCFA is $2,000.[141]

Sections 105A to 105F of the CCCFA provide for the procedure of the infringement offences listed in s 102A. This section provides for the "more straight-forward or minor breaches of the disclosure and repossession provisions".[142] For repossession, lenders or their repossession agents commit an infringement offence if they fail to:

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[135] David Selkirk "New Penalties for Directors for Failure to File Companies Financial Statements" Fortune Manning Lawyers <www.fortunemanning.co.nz>. https://fortunemanning.co.nz/publications/commercial/new-penalties-for-directors-for-failure-to-file-companies-financial-statements/

[136] Companies Act 1993, s 207G.

[137] Financial Markets Conduct Act 2013, s 514.

[138] Fair Trading Act 1986, s 40B.

[139] Fair Trading Act 1986, s 40D.

[140] Ministry of Business, Innovation & Employment *Review of consumer credit regulation: Additional information to support the discussion paper* (June 2018) at 44.

[141] Credit Contracts and Consumer Finance Act 2003, s 105A.

[142] Commerce Commission *Repossession Guidelines* (June 2018) at 24.

- Include one or more of the required pieces of information in a repossession notice;
- Produce a document or information on entering premises for the purposes of repossessing goods.

An infringement notice will impose an infringement fee where:

- The Commission considers, on reasonable grounds, that a person is committing or has committed an infringement offence, and
- No criminal proceedings or infringement notices have already been issued for the offence.[143]

The infringement fee is currently $1,000 for any one infringement offence and can be changed by regulation.[144] The recipient of an infringement notice must either pay the fee or challenge the notice within 28 days of receiving the infringement notice.

For infringement offences to be potentially suitable for use in relation to Lender Responsibility Principles, there will have to be clearly stated obligations on lenders, for example to obtain 60 days of bank statements from a borrower. It is not appropriate to have an infringement offence in relation to a high level principle where there are different ways of complying.

[143] Commerce Commission *Repossession Guidelines* (June 2018) at 24.

[144] Credit Contracts and Consumer Finance Act 2003, s 105A.

10. HOW CONSUMER CREDIT LAWS ARE ENFORCED IN OTHER JURISDICTIONS

AUSTRALIA

Summary of Key Findings

Responsible lending obligations have been in force in Australia in the National Consumer Credit Protection Act 2009 since 2 October 2011.[145] The Australian Securities & Investments Commission (ASIC) has had a range of enforcement powers under that Act since those obligations were introduced, including civil pecuniary penalties, infringement offences, compliance orders, and statutory damages for breaches of the responsible lending obligations.[146] In particular, Australian law provides for civil penalties and includes prescriptive measures around assessing suitability for high cost loans. ASIC has taken several cases to court and significant penalties have been awarded by the court for breaches of the responsible lending obligations. A recent Australian Senate report found that there are still high levels of non-compliance with the responsible lending obligations in relation to high cost lending.[147]

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[145] Australian Securities & Investments Commission *Responsible lending disclosure obligations – Overview for credit licensees and representatives* (INFO 146, 20 October 2014) <www.asic.gov.au>. https://asic.gov.au/regulatory-resources/credit/responsible-lending/responsible-lending-disclosure-obligations-overview-for-credit-licensees-and-representatives/

[146] This has been introduced in the recent reform of consumer credit in New Zealand by the Credit Contracts Legislation Amendment Bill, under amendments relating to pt 4 of the Credit Contracts Act: enforcement remedies, specifically cl 24, 25, 31 and 32.

[147] The Senate Economics References Committee *Credit and hardship: report of the Senate inquiry into credit and financial products targeted at Australians at risk of financial hardship* (Parliament of Australia, February 2019) at 4 and 77.

Responsible Lending Obligations

The National Consumer Credit Protection Act 2009 (NCCPA) includes responsible lending obligations, which apply to all consumer credit providers and consumer credit assistance providers. This Act also includes the National Credit Code (NCC) in Schedule 1 of the Act, which contains requirements in relation to the entry into, terms and enforcement of credit contracts and consumer leases. The responsible lending obligations are intended to:[148]

a) Introduce standards of conduct to encourage prudent lending and leasing, and impose sanctions in relation to irresponsible lending and leasing;[149] and
b) Curtail undesirable market practices, particularly where intermediaries are involved in lending.[150]

The meaning of “credit service” and “credit assistance” are defined in ss 7 and 8 of the NCCPA. “Credit assistance” covers people who suggest that the consumer apply or remain in or assist with a credit contract with a particular credit provider or in a particular consumer lease with a particular lessor, or suggest that the consumer apply or assists in applying, for an increase to the credit limit of a particular credit contract with a particular credit provider.[151] Note that responsible lending obligations do not apply solely to new credit contracts and consumer leases, but also apply when suggesting an increase to the credit limit or assisting the consumer to apply for an increased credit limit, or suggesting to the consumer that they should remain in the contract.

The responsible lending conduct obligations are in chapter 3 of the NCCPA. This requires a “credit licensee”, which includes both licensees that provide credit assistance to consumers in relation to credit contracts and consumer credit providers, to undertake three steps to meet the responsible lending obligations:

1. Make reasonable inquiries about the consumer’s financial situation, and their requirements and objectives in relation to the credit contract;
2. Take reasonable steps to verify the consumer’s financial situation; and
3. Make a preliminary assessment (if providing credit assistance) or final assessment (by the credit provider) about whether the credit contract is ‘not unsuitable’ for the consumer (based on the inquiries and information obtained in the first two steps).[152]

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[148] Australian Securities & Investments Commission “Credit” (20 October 2014) <www.asic.gov.au>. https://asic.gov.au/regulatory-resources/credit/
[149] National Consumer Credit Protection Bill 2009 (Cth) (explanatory memorandum) at [3.16].
[150] At [3.11].
[151] National Consumer Credit Protection Act 2009 (Cth), ss 7 and 8.
[152] National Consumer Credit Protection Act 2009 (Cth), s 116.

The key concept is that credit licensees must not enter into a credit contract or consumer lease with a consumer, suggest a credit contract or consumer lease with a consumer or assist a consumer to apply for a credit contract or consumer lease if the credit contract or consumer lease is unsuitable for the consumer.[153]

A credit contract or consumer lease will be unsuitable if at the time of the assessment:

1. The contract does not meet the consumer's requirements and objectives;
2. The consumer will be unable to meet their payment obligations, either at all or only with substantial hardship; or
3. Other circumstances prescribed in the regulations apply to the contract.[154]

The credit provider or credit assistance provider is also required to, upon request, provide the consumer with the written copy of the preliminary or final assessment. This means that the credit provider or credit assistance provider must keep a record of all material that informs the assessment that the consumer is "not unsuitable" for a credit contract or consumer lease.

For small amount credit contracts (SACCs), the credit contract must be presumed to be unsuitable if at the time of the preliminary assessment, the consumer is a debtor under another SACC, and the consumer is in default in payment of an amount under that other contract; or in the 90-day period before the time of the preliminary assessment, the consumer has been a debtor under 2 or more other SACC. It is presumed that the consumer could only comply with their financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.[155] This is the rebuttable presumption that is referred to by some of the submitters to the June 2018 Discussion Paper and suggested for inclusion in New Zealand's regime.

[153] Australian Securities & Investments Commission *Credit licensing: Responsible lending conduct* (Regulatory Guide 209, November 2014) at 4.

[154] At 5.

[155] National Consumer Credit Protection Act 2009 (Cth), s 118(3A).

There are also additional responsible lending obligations for an SACC. A credit contract is a SACC if:

a) The contract is not a continuing credit contract; and
b) The credit provider under the contract is not an ADI (authorised deposit taking institution); and
c) The credit limit of the contract is $2,000 (or such other amount as is prescribed by the regulations), or less; and
d) The term of the contract is at least 16 days but not longer than 1 year (or such other number of years as is prescribed by the regulations); and
e) The debtor's obligations under the contract are not, and will not be, secured; and
f) The contract meets any other requirements prescribed by the regulations.[156]

For SACCs, the responsible lending obligations require the credit licensee or credit applicant to:

a) Inquire whether the consumer is currently in default under an existing SACC, or has been a debtor under two or more SACC in the 90-day period before the assessment;
b) Inquire about the source and amount of the consumer's gross income because a consumer who receives at least half their gross income under the Social Security Act 1991, with their repayments exceeding a specified proportion of their gross income, is prohibited from entering into a SACC;
c) Verify the consumer's financial situation by obtaining and considering recent bank account statements; and
d) Make inquiries about whether the credit obtained will be used to repay another SACC because there is a restriction on the fees that can be charged for a SACC where it is used to refinance any amount provided under another SACC.[157]

Currently, a SACC protected earnings amount exists for Centrelink beneficiaries who receive 50% or more of their income from Centrelink and the portion of income is 20% of gross income.[158] The SACC regime was reviewed by a panel appointed by the Australian government in 2015. The final report of the panel recommended that the protected earnings amount be extended to cover all consumers and that the 20% figure be reduced to 10% so that the total of all SACC repayments could not exceed 10% of the borrowers net income. This recommendation was accepted by the government and included in a bill then drafted by Treasury. A recent (2019) Australian Senate inquiry has recommended that that bill be progressed.

[156] National Consumer Credit Protection Act 2009 (Cth), s 5.

[157] Australian Securities & Investments Commission *Payday lenders and the new small amount lending provisions* (Report 426, March 2015) at 5.

[158] National Consumer Credit Protection Regulations 2010, r 28S.

The Senate inquiry also recommended that the protected earnings amount apply to consumer leases. Many low-income consumers, who are Centrelink beneficiaries, make their consumer lease payments through Centrepay, which allows payments to be directly deducted from the consumer's Centrelink payment.[159] New regulations are expected to be introduced for Centrelink recipients in respect of consumer leases: "A new protected earnings amount will be introduced for consumer leases for household goods, whereby lessors cannot enter into a contract that would require a consumer to pay more than 10 per cent of their income in rental payments under consumer leases for household goods. Under the protected earnings amount, the total rental payments (including under the proposed lease) cannot exceed 10 per cent of net income in each payment period."[160]

Enforcement Measures

The national credit licensing regime is overseen by the Australian Securities and Investments Commission (ASIC).[161] In enforcing the NCCPA, ASIC's aim is to ensure that "consumers are not trapped in a cycle of disadvantage and that vulnerable consumes are protected from practices which reduce financial and social inclusion".[162] The power of the court to grant remedies is in ss 176-194 of the NCCPA.

Punitive Action

1. Prison Terms and Court Orders

ASIC can pursue prison terms and other criminal remedies for the most serious conduct, such as misconduct that has a widespread negative impact on investors or creditors. Most serious conduct includes conduct that is dishonest, intentional or highly reckless, and criminal action will be considered for these offences.[163]

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[159] Senate Economics References Committee "Credit and hardship: report of the Senate inquiry into credit and financial products targeted at Australians at risk of financial hardship" (February 2019) at 36.

[160] Senate Economics References Committee "Credit and hardship: report of the Senate inquiry into credit and financial products targeted at Australians at risk of financial hardship" (February 2019) at 51 and 52; Australian Securities & Investments Commission "Recommendations of the Review of the small amount credit contract laws: Submission by the Australian Securities and Investments Commission" (June 2016) at 5.

[161] Marcus Banks, Ashton De Silva and Roslyn Russell *Trends in the Australian Small Loan Market* (School of Economics, Finance and Marketing RMIT University, October 2015) at 19.

[162] Australian Securities & Investments Commission *Payday lenders and the new small amount lending provisions* (Report 426, March 2015) at 4.

[163] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 5.

For example, a two year imprisonment term is available to be sought by ASIC if a credit licensee suggests that the consumer apply, or assists the consumer in applying, for an unsuitable credit contract; or the licensee suggests the consumer apply, or assists them in applying for an increase to the credit limit of a credit contract, which is unsuitable.[164] A credit contract being "unsuitable" for the consumer is defined as being where it is likely that:

a) The consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship; or
b) The contract will not meet the consumer's requirements or objectives; or
c) If the regulations prescribe circumstances in which a credit contract is unsuitable – those circumstances will apply to the contract.[165]

The same criminal penalty of a term of imprisonment is available for ASIC to seek if the credit licensee enters, or increases the credit limit of, unsuitable credit contracts.[166]

If ASIC consider the evidence they gathered to be sufficient to support the view that a criminal offence has been committed, ASIC refers this to the Commonwealth Direct of Public Prosecutions (CDPP) who determine whether the evidence is sufficient to commence criminal proceedings and whether prosecution is in the public interest after consulting with ASIC. CDPP then commence the criminal proceedings if CDPP and ASIC decide that criminal proceedings are the best course of action.[167]

2. Criminal Financial Penalties

Breaches of responsible lending obligations can also attract criminal fines, which are ordered by a court and may be relatively small. These will be ordered for "regulatory offences that disrupt the smooth functioning of the regulatory regime". The lowest maximum penalty is $850. The seriousness of the offence will be reflected in the amount imposed by the fine.[168]

[164] National Consumer Credit Protection Act 2009 (Cth), s 123(1) is the responsible lending obligation. Section 123(6) provides for the criminal penalty of either 200 penalty units, or 2 years imprisonment, or both if s 123 is breached.
[165] Section 123(2).
[166] Section 133(6).
[167] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 5.
[168] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 5.

The value of the Commonwealth penalty unit is $210, as of 1 July 2017.[169]

3. Civil Financial Penalties

Civil financial penalties are available to the court to impose on lenders who breach the responsible lending obligations. These are available as an alternative to prosecuting under criminal law. Civil financial penalties are of great seriousness and can attract high penalties if successful. A range of penalties is available under this category, including banning orders, orders of disqualification, compensation or pecuniary penalties.

A banning order is a written order made by ASIC "that prohibits a person from engaging in any credit activities or specified credit activities in specified circumstances or capacities".[170] This order can be permanent, or for a specified period.[171] It can be made against an entity and also the natural persons behind the entity if they have been "involved" in a contravention. Examples of when ASIC can make a banning order against a person include if the person has, or is likely to, contravene any credit legislation, or has been, or may be, involved in a contravention of a provision of any credit legislation by another person.[172] Another situation where ASIC can make a banning order is if they have reason to believe that the person is not a fit and proper person to engage in credit activities.[173] ASIC may apply to the court for an order disqualifying the person permanently, or for a specified period, from engaging in credit activities, or specified credit activities,[174] if ASIC has cancelled a licence of a person or they have made a banning order against the person that is to operate permanently.[175]

The Court may order a person to pay compensation if they have contravened a civil penalty provision which has resulted in loss or damage from the contravention or commission of the offence. This order can only be made if the plaintiff, or ASIC on behalf of the plaintiff, applies for a compensation order and this is made within six years of the cause of action that relates to the contravention or commission of the offence.[176]

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[169] Crimes Act 1914 (Cth), s 4AA(1); Australian Taxation Office "Commonwealth penalty units increase" (8 August 2017) <www.ato.gov.au>. https://www.ato.gov.au/Business/Large-business/In-detail/Business-bulletins/Articles/Commonwealth-penalty-units-increase/

[170] National Consumer Credit Protection Act 2009 (Cth), s 81(1).

[171] Section 81(2).

[172] Section 80(1)(d) and (e).

[173] Section 80(1)(f).

[174] Section 86(2).

[175] Section 86 (1).

[176] Section 178.

The purpose of pecuniary penalties is to specifically deter the contravenor and generally deter others against engaging in the type of conduct that is the subject of the contraventions.[177] A sufficiently high price is to be imposed on the contravention so that the deterrence objective is met and so the contravenor or potential contravenors do not consider this to be an acceptable cost of doing business.[178]

Under the NCCPA, ASIC may apply to the Court for a declaration that there has been contravention of a civil penalty provision by a person within six years of the contravention.[179] The Court must make the declaration if it is satisfied that the person has contravened the position.[180] In addition to the power of ASIC being able to order a declaration, they may also apply to the court for an order that the person pay the Commonwealth a pecuniary penalty within six years of the contravention.[181] If the Court makes a declaration that there has been contravention of a civil penalty provision, then they may order the person to pay to the Commonwealth a pecuniary penalty that they consider appropriate,[182] subject to a maximum amount stated in s 167(3), which provides for a limit according to the number of penalty units referred to in the civil penalty provision.[183] If the person is a natural person, then the limit is for the maximum number of penalty units provided for in the civil penalty provision.[184] If the person is a body corporate, a partnership or multiple trustees, then the limit is five times the maximum number of penalty units referred to in the civil penalty provision.[185]

The Australian Securities and Investments Commission Act 2001 (ASIC Act) includes the relevant matters for the Court to consider in imposing the pecuniary penalty. The Court must take into account the following considerations when deciding the appropriate pecuniary penalty:

a) The nature and extent of the act or omission and of any loss or damage suffered as a result of the act or omission; and
b) The circumstances in which the act or omission took place; and

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[177] *NW Frozen Foods v Australian Competition and Consumer Commission* (1996) 141 ALR 640; *Australian Competition and Consumer Commission v Dateline Imports Pty Ltd (No 2)* [2014] FCA 1222 as cited in *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [11].

[178] *Trade Practices Commission v CSR Ltd* (1991) ATPR 41-076; [1990] FCA 521 as cited in *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [11].

[179] National Consumer Credit Protection Act 2009 (Cth), s 166(1).

[180] Section 166(2).

[181] Section 167(1).

[182] Section 167(2).

[183] Section 167(3).

[184] Section 167(3)(a).

[185] Section 167(3)(b).

c) Whether the person has previously been found by the Court in proceedings under the pecuniary penalties provision to have engaged in any similar conduct.[186]

"In setting the penalties to be imposed, it is necessary to take into account the extent to which the same wrongful conduct involved a breach of more than one civil penalty provision."[187]

Other Actions

1. Preservative Action

ASIC can take court action to protect assets, by preventing assets being moved or used, or compel someone to comply with the law, for example, by injunction. ASIC can also work with the CDPP or Australian Federal Police to prevent dealings in or confiscate proceeds of crime.[188]

2. Corrective Action

ASIC can seek a court order for corrective disclosure, for example, to correct a misleading or deceptive advertisement.[189]

3. Compensation Action

ASIC can begin a representative action to recover damages or property for persons who have suffered loss. This will only be done if it is in the public interest to take such action.[190]

4. Negotiated Resolution

Negotiated resolutions can be used as alternative to, or in conjunction with, remedies where these can achieve an effective regulatory outcome, for example, an improved compliance programme. An enforceable undertaking does not involve court proceedings, but they may

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[186] Australian Securities and Investments Commission Act 2001 (Cth), s 12GBA(2); *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [5].

[187] National Consumer Credit Protection Act 2009 (Cth), s 175; *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [13].

[188] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 6.

[189] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 6.

[190] Australian Securities & Investments Commission Act, s 50; Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 6.

include other beneficial regulatory outcomes, such as "providing compensation or outlining a process to monitor a person's continuing compliance with the law".[191]

5. Infringement Notices

ASIC can issue infringement notices for certain contraventions of the ASIC Act, which include unconscionable conduct and consumer protection provisions and for contraventions of the NCCPA. Infringement notices for these breaches are "intended to facilitate payment of relatively small financial penalties in relation to relatively minor contraventions". If an infringement notice is complied with, for example, the penalty is paid by the contravenor, then no further regulatory action can be taken against the recipient for that breach. If there is non-compliance with the notice, then ASIC can bring a civil penalty action against the notice recipient.[192] Breaches of numerous obligations under the NCCPA give rise to infringement offences. These are listed in the National Consumer Credit Protection Regulations 2010, r 38. For example and relevantly, the failure to make a preliminary assessment that a credit contract is unsuitable in the circumstances where the rebuttable presumption arises constitutes an infringement offence.

Financial Counsellors (i.e. Financial Mentors in New Zealand)

Consumers in Australia can go to community organisations, community legal centres and some government agencies to receive free financial counselling services. Financial counsellors can:

- Suggest ways to improve the consumer's financial situation,
- See if the consumer is eligible for government assistance,
- Negotiate repayment arrangements with the consumer's creditors,
- Explain the options available to the consumer and their consequences, including debt recovery procedures, bankruptcy and other alternatives,
- Help the consumer apply for a hardship variation,
- Help the consumer organise their finances and budget, and
- Refer the consumer to other services, for example, a gambling helpline, family support, personal counselling or community legal aid.[193]

[191] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 6.
[192] Australian Securities & Investments Commission *ASIC's approach to enforcement* (Information Sheet 151, September 2013) at 7.
[193] Australian Securities & Investments Commission "Financial counselling" (25 October 2018) ASIC's MoneySmart <www.moneysmart.gov.au>. https://www.moneysmart.gov.au/managing-your-money/managing-debts/financial-counselling

Financial counsellors can also help with the following problems:

- Debts that the consumer is struggling to pay,
- Threatening letters or harassment by debt collectors,
- Debt recovery through the courts,
- House eviction, disconnection of gas, electricity, phone etc, and
- Uninsured car accidents, taxation debts and unpaid fines.[194]

Cases enforcing the responsible lending obligations

1. *Australian Securities & Investments Commission v The Cash Store Pty Ltd (in liq)* [2014] and *(No 2)* [2015]

A significant case on enforcement issues in Australia is *Australian Securities & Investments Commission v The Cash Store Pty Ltd (in liquidation)*[195] (*ASIC v The Cash Store*) where the Federal Court of Australia found The Cash Store (TCS), a credit assistance provider, and Assistive Finance Australia (AFA), a credit provider, breached provisions of the responsible lending obligations.[196] The established breaches included:

- Failing to provide the TCA credit guide to the customer under s 113(1) in relation to 96 contracts;
- Entering into a credit contract with a consumer without making a preliminary assessment covering the period proposed for the contract under s 115(1)(c) in relation to 277 contracts;
- Failing to undertake reasonable inquiries about a customer's requirements and objectives in relation to 224 contracts, by failing to undertake reasonable inquiries about a customer's financial situation (268 contracts), and in relation to 151 contracts by failing to undertake reasonable verification under s 115(1)(d);
- Failing to make a preliminary assessment to assess whether the credit contract would be unsuitable for the consumer if the contract was entered or the credit limit was increased in accordance with s 116(1);
- Failing to make reasonable inquiries about the customer's requirements and objectives in relation to 224 contracts under s 117(1)(a);

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[194] Australian Securities & Investments Commission "Financial counselling" (25 October 2018) ASIC's MoneySmart <www.moneysmart.gov.au>. https://www.moneysmart.gov.au/managing-your-money/managing-debts/financial-counselling

[195] *Australian Securities & Investments Commission v The Cash Store Pty Ltd (in liq)* [2014] FCA 926 (V).

[196] Nicola J Howell "Small Amount Credit Contracts and Payday Loans: The complementarity of price regulation and responsible lending regulation" (2016) 41(3) AltLJ 174 at 174.

- Failing to make reasonable inquiries about a customer's financial situation in relation to 268 contracts under s 117(1)(b);
- Failing to undertake reasonable verification by a failure to take reasonable steps to verify the customer's financial situation in relation to 151 contracts under s 117(1)(c).[197]

ASIC had conducted the investigation into the conduct of TCS and AFA under their powers to investigate in s 247 of the NCCPA. AFA and TCS had a business arrangement where AFA outsourced to TCS the full "servicing" of the payday loans that AFA funded. TCS described their role as similar to that of "a mortgage manager who originates and manages loans for an arm's length funder".[198]

The pecuniary penalty provisions in the ASIC Act and the NCCPA were used by the Court in this case to determine the appropriate penalty for TCS and AFA's breaches of the responsible lending obligations.[199] In setting the penalty, the Court took into account the statistical likelihood of similar contraventions in respect of all the contracts entered into over the period of July 2010-September 2012. This was split into two periods, being July 2010-March 2012 and March 2012-September 2012 as TCS made some attempt at corrective action in March 2012, but this was not sufficient to comply with their responsible lending obligations.[200] The Court considered that the contraventions by TCS and AFA were not isolated nor confined instances and that their lending practices fell well short of the responsible lending obligations.[201] Although TCS was in liquidation, it was considered to still be appropriate to impose pecuniary penalties to disapprove of the conduct and acknowledge the seriousness of the contraventions.[202]

For TCS, pecuniary penalties of the maximum penalty of $1.1 million were imposed for the first period, 30% of the maximum penalty of $1.1 million imposed in the second period, and for their accessorial contraventions, 50% of the maximum penalty of $1.1 million for the first period, and 15% of the maximum penalty of $1.1 million imposed for the second period. Each of these penalties applied to the five categories of breaches identified by the Court. The same penalties were imposed on AFA.[203]

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[197] *Australian Securities & Investments Commission v The Cash Store Pty Ltd (in liq)* [2014] FCA 926 (V) at [66].
[198] At [5].
[199] *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [4].
[200] *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93 at [7]-[8].
[201] At [10].
[202] At [12].
[203] At [24]-[27].

In a media release by ASIC, it was noted that the penalties imposed on TCS and AFA were the largest civil penalties that had at the time been obtained by ASIC. ASIC stated that "the decision demonstrates the importance of lenders complying strictly with their responsible lending obligations, including making proper inquiries about the consumer's income and living expenses and obtaining all necessary information to enable a meaningful suitability assessment to be made." ASIC stated this was a landmark case and that "the significant size of the penalty imposed shows ASIC and the Court takes these obligations very seriously, as must all lenders, no matter how small the loan is".[204]

2. *Australian Securities & Investments Commission v Channic Pty Ltd (No 4)* [2016] and *(No 5)* [2017]

The proceedings in *Australian Securities & Investments Commission v Channic Pty Ltd (No 4)* (*Channic (No 4)*) were brought against lender Channic Pty Ltd (Channic), broker Cash Brokers Pty Ltd (CBPL) and the sole director of both companies, Mr Hulbert. Proceedings were commenced after an investigation revealed that CBPL were assisting consumers to obtain loans from Channic at an interest rate of 48% to purchase vehicles from Supercheap, a related entity. This was in addition to charging brokerage fees of up to $990. Channic did not assess whether the loans were suited to the consumers' requirements. This was because of the Indigenous Consumer Assistance Network (ICAN) reporting that Channic and Cash Brokers were dealing unjustly with vulnerable Indigenous consumers from the community of Yarrabah. ICAN provides financial counselling services to Indigenous consumers in North Queensland and noticed that many of their clients were suffering financial hardship as a result of loans they had taken out with Channic.[205]

The causes of action against Channic were that:

1. Channic contravened ss 128, 130, 131 and 133 of the NCCPA which include the responsible lending obligations of assessing unsuitability, making reasonable inquiries about the consumer and not entering, or increasing the credit limit of, unsuitable credit contracts.
2. A declaration that the credit contracts entered into by Channic were unjust within the meaning of s 76 of the NCC,[206] a finding of which would allow the Court to reopen the transactions that gave rise to the contracts.

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[204] Australian Securities & Investments Commission "15-032MR Federal Court orders record penalty" (press release, 19 February 2015).

[205] Australian Securities & Investments Commission "18-065MR ASIC winds up Cairns-based car lender for unpaid fines" (press release, 6 March 2018).

[206] National Consumer Credit Protection Act 2009 (Cth), sch 1 s 76.

3. A declaration that Channic engaged in unconscionable conduct in contravention of s 12CB of the ASIC Act.[207]

The causes of action against CBPL were that:

a) CBPL contravened ss 113, 114, 115, 117, 118, 121 and 123 of the NCCPA, which include providing a credit guide to the consumer, providing a quote for credit assistance, making a preliminary assessment before providing credit assistance, assessing the credit contract as unsuitable, disclosing the fees in a credit proposal disclosure document, and not suggesting or assisting consumers in entering, or increasing the credit limit of, unsuitable credit contracts.[208]

The causes of action against Mr Hulbert were that, as the sole shareholder and sole director of Channic, and the sole director and a shareholder in CBPL, he contravened ss 113, 114, 115, 117, 118, 121, 123, 128, 130, 131 and 133 of the NCCPA, descriptions of which are in the above paragraphs.[209]

Channic and CBPL operated from Supercheap, a used car dealership which was also owned by Mr Hulbert. The case involved eight loans for the purchase of vehicles. The sales of the cars would usually be financed by loans. Supercheap would be the seller and would convey title to the consumer, Channic would provide loans to consumers to buy the vehicles. CBPL was said to "purport" to broker a loan from Channic to assist a customer to purchase the vehicle. Supercheap advertised that finance would be offered to buyers: with a 20 minute onsite approval; to persons in receipt of Centrelink income; to persons with bad credit histories; and to ex-bankrupts.[210]

The two companies and Mr Hulbert were ordered to pay pecuniary penalties of $278,000 and $220,000 respectively. The credit contracts with all eight consumers subject to the proceedings were set aside and they were relieved from any liability.[211]

This case contains a comprehensive summary of the Australian statutory regime, starting from the "Reasons for Judgment".

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[207] *Australian Securities & Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174 at [59, [60] and [61].
[208] At [67].
[209] At [69].
[210] *Australian Securities & Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174 at [92] and [94]; David Jacobson "Case note: Channic responsible lending breach penalty" (11 April 2017) Bright Law <www.brightlaw.com.au>. https://www.brightlaw.com.au/case-note-responsible-lending-breach-penalty/
[211] *Australian Securities & Investments Commission v Channic Pty Ltd (No 5)* [2017] FCA 363 at [1], [2] and [3].

3. *Australian Securities & Investments Commission v Financial Circle Pty Ltd* [2018]

This case concerns the lender, Financial Circle Pty Ltd (Financial Circle) making false representations that:

a) It operated a business of providing investment loans, home loans, plant and equipment loans, car loans and business loans; and
b) In respect of person loans provided by it, there were no significant loan requirements, features or fees other than those identified on the *"Good Credit Personal Loans"* and *"Bad Credit Personal Loans"* webpages of its website.[212]

By making these false representations, Financial Circle engaged in misleading or deceptive conduct in contravention of:

i. Section 1031H of the Corporations Act 2001;
ii. Sections 12DA and 12DF of the ASIC Act, which provide that a person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive, and that a person must not, in trade or commerce, engage in conduct that is liable to mislead the public as to the nature, the characteristics, the suitability for their purpose or the quantity of any financial services;
iii. Section 160D of the NCCPA, which provides that a person must not, in the course of engaging in a credit activity, give information or a document to another person if the give knows, or is reckless as to whether, the information or document is false in a material particular, or is materially misleading. This is part of the responsible lending obligations in chapter 3 of the NCCPA.[213]

Financial Circle offered personal loans to consumers of up to $5,000 that could only be obtained if the consumer agreed to receive and implement financial advice. The consumer would be given advice to purchase personal insurance products and switching superannuation providers. When the consumer implemented the advice, significant advice fees were paid to Financial Circle directly from the consumer's superannuation. Financial Circle also received ongoing commission payments from the insurers. "This process often resulted in a substantial erosion – in many cases up to 30% - of the client's superannuation balances".[214]

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[212] *Australian Securities & Investments Commission v Financial Circle Pty Ltd* [2018] FCA 1644 at [1] of "The Court declares that".

[213] *Australian Securities & Investments Commission v Financial Circle Pty Ltd* [2018] FCA 1644 at [1] of "The Court declares that".

[214] Australian Securities & Investments Commission "18-334MR Melbourne financial services and credit business to pay $9 million for multiple breaches of obligations and consumer protection laws" (press release, 5 November 2018).

The Court made an order for a permanent injunction restraining Financial Circle, whether by itself, its servants, agents or employees, from

a) Carrying on a financial services business, or carrying on a business related to, concerning or directed to financial products or financial services
b) Providing financial product advice, dealing in financial products, or holding itself to any of these matters.

Financial circle, whether by itself, its servants, agents or employees, are also permanently restrained by injunction from providing credit or entering into a credit contract as a credit provider or in any way being involved in, or holding itself out as being involved in, any of these matters.[215]

Pecuniary penalties were ordered for $2,100,000 in respect of Financial Circle's misleading or deceptive conduct directed to the public, $1,680,000 in respect of unconscionable conduct directed to the public, $2,100,000 in respect of misleading or deceptive conduct directed to applicants, $1,680,000 in respect of unconscionable conduct directed to applicants, $1,000,000 in respect of its failure to take reasonable steps to ensure that its authorised representatives complied with provisions in the Corporations Act, and $420,000 for engaging in a credit activity without a licence.[216] These total $8,980,000 in pecuniary penalties.

4. *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Limited* [2018]

In this action, Australia and New Zealand Banking Group Ltd (ANZ) was found to have contravened ss 128, 129 and 130 of the NCCPA. Section 128 of the NCCPA requires the credit provider to make a preliminary assessment of the consumer by taking reasonable steps to verify the consumer's financial situation before entering the loan under s 130(1)(c) of the NCCPA, meaning that ANZ also contravened s 130(1) of the NCCPA. These contraventions occurred in loans with 12 consumers.[217]

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[215] *Australian Securities & Investments Commission v Financial Circle Pty Ltd* [2018] FCA 1644 at [1] of "The Court orders that".

[216] *Australian Securities & Investments Commission v Financial Circle Pty Ltd* [2018] FCA 1644 at [3]-[8] of "The Court orders that".

[217] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [1].

The loans that were the concern of these proceedings included credit contracts that were provided to ANZ by third party intermediaries, which were motor vehicle and motorcycle dealerships.[218]

ANZ was ordered to pay pecuniary penalties of $5 million in respect of the contraventions of s 130(1)(c) of the NCCPA by failing to take reasonable steps to verify the consumer's financial situation.[219] This penalty was suggested by the parties and was considered to be appropriate by the Court. The reasons for this were:

- ANZ did not completely fail to verify the financial situation of the consumers. In verifying the income of the consumers, it inappropriately relied entirely on payslips received from the intermediaries.
- ANZ's co-operation and the "totality principle" should be recognised to reduce the penalty.
- A total penalty of $5 million is sufficient as a deterrent, and ensures that the penalty for contravening the Act is not seen as a "cost of doing business".[220]

The Court noted that these contraventions of ss 128, the obligation to assess unsuitability, and 130(1)(c), the obligation to take reasonable steps to verify the consumer's financial situation, warranted significant penalties because

- This would provide a general deterrence because in these circumstances, ANZ is a very substantial and profitable enterprise;
- ANZ was aware of their responsibilities and had the capacity to fulfil its obligations;
- The effectiveness of the statutory scheme depends on lenders like ANZ taking their obligations seriously;
- The obligation to verify a consumer's income is important in ensuring that lenders and consumers do not enter into contracts that may be unsuitable;
- The contraventions were repeated and occurred over a period of two years; and
- ANZ management did not ensure that relevant policies were complied with. For one of the motor vehicle dealers in particular, ANZ management was aware of the issues

[218] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [17].

[219] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [1].

[220] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [30].

affecting the third party and took no action to prevent the contraventions of the NCCPA.[221]

This was balanced by ASIC's recognition that the contraventions were not the most egregious examples of contraventions of the NCCPA. This was because

- ANZ took some steps towards satisfying its statutory obligation but failed to take reasonable steps in that respect;
- ASIC did not allege that ANZ deliberately set out to breach its statutory obligations;
- The involvement of individuals with management responsibilities was limited; and
- Loss or damage was not alleged.[222]

5. *Lynch v Cash Converters Personal Finance Pty Ltd (No 3)* [2017]

This case concerned loans obtained by persons during July 2009 and July 2013 on terms that included the payment of fees styled as brokerage fees. It was part of the applicant's case that the brokerage services provided to him were illusory. It was argued that the applicant's credit worthiness and whether his credit application would be approved was an automated process.[223] ASIC requested documents of Safrock Finance Corporation (Qld) Pty Ltd (Safrock), the second defendant, to determine whether Safrock complied with the responsible lending obligations under the NCCPA.[224] ASIC, in a letter, raised concerns about whether Safrock's affordability calculations of consumers' capacity to service credit contracts sufficiently reflected their pre-existing credit commitments/expenses, and about disclosure concerning repayment of brokerage fees.[225] Following this, a letter was addressed to Cash Converters (Cash Advance) Pty Ltd (Cash Converters) outlining concerns about whether Cash Converters made reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract.[226]

Proceedings are still ongoing.[227]

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[221] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [32].

[222] *Australian Securities & Investments Commission v Australia and New Zealand Banking Group Ltd* [2018] FCA 155 at [33].

[223] *Lynch v Cash Converters Personal Finance Pty Ltd (No 3)* [2017] FCA 371 at [10].

[224] *Lynch v Cash Converters Personal Finance Pty Ltd (No 3)* [2017] FCA 371 at [11].

[225] *Lynch v Cash Converters Personal Finance Pty Ltd (No 3)* [2017] FCA 371 at [12].

[226] *Lynch v Cash Converters Personal Finance Pty Ltd (No 3)* [2017] FCA 371 at [13].

[227] *Lynch v Cash Converters Personal Finance Pty Ltd (No 4)* [2018] FCA 988.

6. *Ennis v Credit Union Australia* [2017]

In this case the Court ordered that the application must be dismissed because the Court was not satisfied that Credit Union Australia or any of its officers made any errors when considering the ability of Ms Ennis and her husband to service the loan they applied for. The Court was also not satisfied that Credit Union Australia ought to have, or was compelled to, assess the credit contract as unsuitable for Ms Ennis or for Ms Ennis and her husband.[228] There was no evidence of irresponsible lending by Credit Union,[229] no evidence of inflating the value of any assets that Ms Ennis and her husband disclosed that they owned,[230] the evidence showed that the loan remained affordable and serviceable with additional expenditure adjusted for,[231] and the evidence showed that the loan remained affordable and assessable even with the income adjustments that Ms Ennis argued for.[232]

7. *Australian Securities & Investments Commission v Kobelt* [2016]

Mr Kobelt operated a general store called "Nobbys Mintabie General Store" (Nobbys) and as part of this, he sold second hand motor vehicles and provided credit to customers by way of a practice described as 'book up'. 'Book up' refers to the practice where a store allows the consumer to obtain the goods and services now and pay later, sometimes leaving the consumer's ATM card as security for the debt.[233] The allegations against Mr Kobelt were that his conduct since 1 July 2011 contravened s 29 of the NCCPA, which prohibits a person from engaging in a credit activity if they do not hold a licence authorising them to engage in that credit activity; and that his conduct was unconscionable under s 12CB of the ASIC Act. This was because Kobelt's conduct since 1 June 2008 required customers of Nobbys to provide him with a debit card linked to a bank account into which their income is paid, as well as the customer's PIN relating to the card. Kobelt used the cards to withdraw all or nearly all of the monies in the account in reduction of the customer's debt on the day payments were made into the account or shortly afterwards. Each of the customers, with one exception, were indigenous people.[234]

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[228] *Ennis v Credit Union Australia* [2017] FCA 549 at [7].
[229] *Ennis v Credit Union Australia* [2017] FCA 549 at [65].
[230] *Ennis v Credit Union Australia* [2017] FCA 549 at [55].
[231] *Ennis v Credit Union Australia* [2017] FCA 549 at [61].
[232] *Ennis v Credit Union Australia* [2017] FCA 549 at [54].
[233] Australian Securities & Investments Commission "Book up" (29 March 2018) ASIC's MoneySmart <www.moneysmart.gov.au>. https://www.moneysmart.gov.au/life-events-and-you/indigenous/book-up
[234] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [3] and [4].

The allegations in respect of unconscionable conduct were that Kobelt, in using at least 117 of his indigenous customers' cards to pay off their debts, was acting unconscionably in breach of s 12CB(4) of the ASIC Act.[235]

Kobelt did not grant credit to all who sought it, if he did not know the customer, he would ask their name, their address, what their income was and when it was paid to make his assessment. Sometimes he would refuse credit because one or more members of the customer's family had previously defaulted in 'book up' arrangements or because the customer came from a community whose people he regarded as unreliable. In the last ten years, Kobelt declined 'book up' to about 12-15 persons.[236] Sometimes Kobelt refused 'book up' to customers known to him, usually because they had previously frustrated his ability to access the funds in their account, by, for example, cancelling the key card or by having their income paid into another account.[237]

Kobelt did not require 'book up' customers to fill in an application form. He did not make any other inquiries apart from enquiring about the amount of the customer's weekly or fortnightly income and when it was paid. He did not ask whether the customer had 'book up' elsewhere, or had other debts, liabilities or commitments. He did not ask about the number of children the customer had or their other commitments because Kobelt said having been living in Mintabie for 27 years, he knew the majority of customers fairly well.[238]

At first instance, the Court determined that ASIC established that Kobelt, from 1 July 2011 to April 2014 contravened, s 29 of the NCCPA by providing credit to purchasers of motor vehicles without holding a licence authorising him to provide such credit, and since 1 July 2008, contravened s 12CB of the ASIC Act by engaging in unconscionable conduct when providing the 'book up' services.[239] Mr Kobelt was ordered to pay $167,500 in pecuniary penalties after the first hearing.[240]

[235] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [5].
[236] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [35].
[237] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [36].
[238] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [37].
[239] *Australian Securities & Investments Commission v Kobelt* [2017] FCA 1327 at [627].
[240] *Australian Securities & Investments Commission (ASIC) v Kobelt* [2017] FCA 387 at [114].

On appeal, the Court found that the primary judge's evaluations of the considerations to be taken into account to determine unconscionability were erroneous. The appellant's conduct could be characterised as unconscionable. The reasons for this were as follows:

1. The relevant system of 'book up' by Kobelt was not a recent nor unique system, the primary judge found that the other two stores in Mintabie had a similar 'book up' system to Kobelt,
2. Kobelt's 'book up' system had advantages to the Nobby's customers in terms of alleviating the disadvantages with demand sharing and boom and bust expenditure,
3. ASIC did not contend and the primary judge did not find that the appellant had adopted forms of "undue influence or exerted undue influence",
4. Kobelt did not make dishonest use of the debit cards or PINS and there was so suggestion that he maintained his records dishonestly,
5. Significantly, despite the disadvantages of the Nobby's customers, including low levels of financial literacy, they understood the basic elements of the 'book up' system, including the Withdrawal Conduct,
6. The primary judge had found that the Nobby's customers voluntarily entered into the 'book up' arrangements. The fact that the Nobby's customers understood the basic elements of the 'book up' arrangements and voluntarily entered into them is a powerful consideration against a finding of unconscionable conduct, particular in the absence of predatory conduct or exploitation, The Court was also not satisfied that Kobelt's conduct was predatory. The Court reviewed the primary judge's findings that the following conduct was predatory and gave its own view of that conduct as follows:
    a. Kobelt required that he be given access to the whole of his customers' income. There was no clear indication of how, in practical terms, this disadvantaged the customers over and above holding their debit cards and PINS;
    b. In relation to a bank glitch where Kobelt was able to withdraw "much more than normal" from the customers' accounts without the customers' authorisation,[241] this was not part of the system of conduct or pattern of behaviour;
    c. The lack of disclosure of the high credit charges was not considered by the appeal Court to be evidence of predatory behaviour and it was relevant that the customers were receiving the motor vehicles at or below market value;
    d. As regards to tying of customers to Nobbys and the charge for purchase orders, and on occasions, for cash, the primary judge had considered this a form of exploitation. However the appeal Court disagreed. The appeal Court did not think that this was a form of predation or exploitation because although the customers were vulnerable, they understood the 'book up' arrangements and voluntarily

[241] *Kobelt v Australian Securities and Investments Commission (ASIC)* [2018] FCAFC 18 at [36].

entered into them. The customers also knew that they could bring the arrangements to an end and some of them did. The tying effect of the conduct was advantageous to Kobelt, but there were also advantages to the Nobby's customers.[242]

Therefore, on appeal, Kobelt's challenge was allowed in part. The contraventions of s 29(1) of the NCCPA, providing credit without a credit licence, was upheld, however, the finding that Kobelt engaged in unconscionable conduct under s 12CB of the ASIC Act was overturned.[243]

The case further appealed to the HCA after there was criticism by ASIC which stated "The end result, unless corrected, will set a lower standard of consumer protection in the case of remote indigenous consumers than for others in Australian society, notwithstanding that such consumers are a group who fall squarely within those the ASIC Act is designed to protect".[244] The matter was adjourned by the High Court of Australia on 4 December 2018.[245]

8. *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 1)* [2015] and *(No 2)* [2015]

From the period from July 2010 to March 2013, Make It Mine Finance Pty Ltd (MIM) entered into 24,377 contracts with customers. For each credit contract, MIM was obliged to include all the information required by s 17 of the NCC, which are the "key requirements".[246] MIM did not include this information in the credit contracts.[247]

From October 2009, MIM supplied computers and associated computer equipment exclusively to customers whose main source of income was Centrelink benefits (i.e. a parenting payment, family tax benefit, disability support pension, aged pension, carer's allowance).[248] Customers applied online or over the phone to purchase a product from MIM. Customers provided authorisation for fortnightly payments for twelve months to be made to MIM through Centrepay,

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[242] *Kobelt v Australian Securities and Investments Commission (ASIC)* [2018] FCAFC 18 at [260]-[269].
[243] *Kobelt v Australian Securities and Investments Commission (ASIC)* [2018] FCAFC 18 at [287] and [288].
[244] Christopher Knaus "Indigenous people face exploitation if illegal credit scheme allowed, Asic warns" (3 December 2018) The Guardian <www.theguardian.com>. https://www.theguardian.com/australia-news/2018/dec/04/indigenous-people-face-exploitation-if-illegal-credit-scheme-allowed-asic-warns
[245] High Court of Australia "Case A32/2018" <www.hcourt.gov.au>. http://www.hcourt.gov.au/cases/case_a32-2018?Itemid=107&print=1&tmpl=component
[246] National Consumer Credit Protection Act 2009 (Cth), sch 1 s 17.
[247] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [2].
[248] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [9].

the direct debit payment system operated by Centrelink.[249] This arrangement was a "lease" of goods, where the Centrepay payments were the "hire fee" payments. The "hire fee" would be paid over 12 months and ownership of the goods would transfer to the customer at the end of the 12 months upon all payments being made.[250] MIM advertised these arrangements as the total cost of the "rental" and did not disclose the true cost of the item, the proportion of the amount paid that represented interest, or the total cost of the item over the course of the 12 months. By emphasising the low weekly cost of the goods for "hire", the substantial gap between the cash price of the goods and the cost price of those same goods was not shown and it seemed that the goods represented value to the consumer.

Until March 2013, the arrangement entered into between each customer and MIM was structured and represented in form to be a "lease" arrangement. In substance however, it was a contract of sale by instalments and therefore, because credit was in substance given and charged for, it was a credit contract and not a consumer lease. These credits contracts between October 2009 and March 2013 affected 25,692 customers and did not disclose:

- The cash price of the goods;
- The annual percentage rate charged under the contract;
- The method of calculation of interest charged under the contract; and
- The total amount of interest charged under the contract.[251]

MIM was not registered or licensed to engage in credit activity on two separate occasions. Between 1 July 2010 and 31 December 2010, MIM provided credit under 1,830 individual contracts and between 1 January 2011 and 20 April 2011, MIM provided credit under 1,784 individual contracts.[252]

The breaches of the responsible lending principles occurred between 21 April 2011 and 1 March 2013, MIM provided credit under 20,763 individual contracts. The procedure for consumer to apply and obtain products from MIM was:

- The customer applied either online or in a telephone call for the product they wanted to purchase.
- MIM required the customer to confirm that he or she:
    - Was in ongoing receipt of Centrelink payments; and
    - Agreed to making payments by a deduction through Centrepay

[249] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [10].
[250] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [11].
[251] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [16].
[252] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [19] and [20].

- The customer was then approved to receive the product and the customer signed and returned to MIM a hard copy of the "hire" agreement.
- MIM then sent the product to the customer.

No other information was collected about the customer's financial situation. No steps were taken to verify the information supplied by the customer, apart from the fact that the customer was in receipt of Centrelink payments. No assessment was undertaken to assess unsuitability.[253]

MIM was ordered to pay a pecuniary penalty of $1,250,000.[254] In setting the penalty, *ASIC v The Cash Store (No 2)* was referred to for the proposition that penalties should be fixed by reference to the categories of contraventions identified in that case.[255] There were two separate periods of time where licensing breaches occurred. The breaches of the responsible lending principles included the failure to make an assessment in relation to a particular contract, the failure to make reasonable inquiries about a consumer's financial situation, and the failure to verify a consumer's financial situation in relation to a particular credit contract.[256] Disclosure breaches included failure to disclose the amount of credit, failure to disclose the annual percentage rate of interest, failure to disclose the method of calculation of interest and the frequency with which interest charges are to be debited, and failure to disclose the total interest charges payable.[257] The penalty for the disclosure breaches was $500,000, for the licensing breaches this was $250,000 and for the responsible lending breaches this was $500,000.[258]

Regulation on interest rates for high cost loans

In 2013, Australia introduced reforms on the high cost lending market by introducing separate categories for loans. Short term loans, or "SACCs" (small amount credit contracts) are loans for amounts of up to $2,000 for longer than 15 days, but less than one year. For SACCs, no interest can be charged but the lender can charge an establishment fee of up to 20% of the loan amount, a monthly fee of up to 4%, a default fee, enforcement costs and any government fee payable.[259]

For more information on the interest rate regime in Australia, see the paper *"Interest rate caps, what do we know about their use and impact in other jurisdictions and how might they contribute*

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[253] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 93 at [22], [23] and [24].
[254] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 2)* [2015] FCA 1255 at [16].
[255] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 2)* [2015] FCA 1255 at [26].
[256] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 2)* [2015] FCA 1255 at [35].
[257] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 2)* [2015] FCA 1255 at [38].
[258] *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd (No 2)* [2015] FCA 1255 at [88] and [92].
[259] Australian Securities & Investments Commission "Payday loans" (25 October 2018) ASIC's MoneySmart <www.moneysmart.gov.au>. https://www.moneysmart.gov.au/borrowing-and-credit/payday-loans

to a fairer consumer credit regime in New Zealand" prepared as part of the research funded by the Borrin Foundation on consumer credit reform.

Dispute Resolution in Australia

From 1 November 2018, all new financial services complaints are dealt with by the Australian Financial Complaints Authority (AFCA), rather than the previous three separate dispute resolution services which were the Financial Ombudsman Service, Credit and Investment Ombudsman, and Superannuation Complaints Tribunal. Membership of the AFCA is required under law or a licence condition of a financial firm. AFCA operations are financed by contributions made by its members and the service is free to consumers.[260] AFCA are also dealing with all complaints lodged prior to 1 November 2018 with the Financial Ombudsman Service and the Credit and Investment Ombudsman.[261]

AFCA can consider complaints from consumers about credit products including credit cards, interest-free finances, lines of credit/overdrafts, and hire purchase/leases. Finance products that AFCA can receive complaints about include short-term finance, short term being defined as a period of time of less than one year. Loan products that AFCA can receive complaints about are construction loans, personal loans, home loans, equity releases, margin loans, and investment property loans. AFCA can receive complaints about guarantees relating to debts including bank guarantees and business guarantees.[262]

The types of complaints that AFCA can consider about credits, loans and finance products include:

- Advice the consumer received or that was not provided that may have been inappropriate or misleading;
- Charges that were incorrectly applied, or costs that were calculated or charged incorrectly;
- Disclosures that were incorrect, insufficient or misleading information about costs or fees, or about the product provided to the consumer;

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[260] Tony Ibrahim "New authority to handle financial disputes" (16 February 2018) Choice <www.choice.com.au>. https://www.choice.com.au/money/banking/everyday-banking/articles/afca-to-launch-in-november-160218; CPA Australia "Australian Financial Complaints Authority" <www.cpaaustralia.com>. https://www.cpaaustralia.com.au/professional-resources/financial-planning/afca

[261] Financial Ombudsman Service Australia (1 November 2018) <www.fos.org.au>; Credit & investments Ombudsman (1 November 2018) <www.cio.org.au>.

[262] Australian Financial Complaints Authority "Credit, finance and loan products and issues" <www.afca.org.nz>. https://www.afca.org.au/make-a-complaint/credit-finance-and-loan-complaints/credit-finance-and-loan-products-and-issues/

- Financial difficulty where the consumer's request to vary their repayments was declined or not responded to – or the consumer has been issued a default notice;
- Decisions about irresponsible lending, or if the consumer believes that a financial firm is pursuing them for a debt that is not theirs or not outstanding. AFCA can also consider complaints about the financial firm's interpretation of product terms and conditions;
- Instructions the consumer gave the financial firm that the firm did not follow or delayed in following;
- Privacy and confidentiality, including complaints about consumer or commercial credit reporting, or where the consumer was refused access to personal information, and other privacy breaches including inappropriate collection or use (including disclosure) of personal information;
- Transactions such as incorrect or dishonoured transactions, mistaken payments or unauthorised transactions.

However, AFCA cannot consider complaints about the level of a fee, premium, charge, rebate or interest rate unless the consumer's complaint is about one of the above issues, for example, if the consumer is complaining about a fee that was not disclosed or was misrepresented. AFCA also cannot consider complaints about credit, for example, they cannot consider a complaint about the financial firm's assessment of a borrower's credit risk, unless the complaint is that the financial firm did not lend responsibly, loan management or security matters, or if there is an element of financial hardship.[263]

In the first month of AFCA's establishment in November 2018, they received an average of 310 complaints each business day, which is a 47% increase on complaints from the three bodies which merged to form AFCA. This has been attributed to AFCA's significantly bigger financial threshold, increased jurisdiction and ability to award higher levels of compensation than its predecessors.[264]

Irresponsible lending in Australia in the high cost lending market – recent evidence

The Inquiry into Credit and Hardship: Report of the Senate Inquiry into Credit and Financial Products Targeted at Australians at Risk of Financial Hardship (2019 Senate Inquiry) that reported in 2019 found that in the high cost lending market, there was significant non-

[263] Australian Financial Complaints Authority "Credit, finance and loan products and issues" <www.afca.org.nz>. https://www.afca.org.au/make-a-complaint/credit-finance-and-loan-complaints/credit-finance-and-loan-products-and-issues/

[264] John Collett "Consumer complaints surge on the back of royal commission revelations" (12 December 2018) The Sydney Morning Herald <www.smh.com.au>. https://www.smh.com.au/money/planning-and-budgeting/consumer-complaints-royal-commission-revelations-acfa-20181206-p50kpq.html

compliance with responsible lending laws, stating:[265] "There are, for instance, real doubts about whether pay day lenders comply with responsible lending obligations."

Many submissions to the 2019 Senate Inquiry gave concrete examples and case studies of poor conduct by lenders, stating: [266] "Even when lenders are regulated, compliance with responsible lending obligations is lacking. In particular, lenders do not inquire thoroughly as to the circumstances of the customer, they do not check the accuracy of income and expense figures provided to them, and even where they obtain three months bank statements as required by law they do not analyse them properly." As an example: "Just last month we sent a group complaint to ASIC alleging breaches of the National Credit Act by Cash Converters, all of which involve loans over the last 18 months… In one example, our client told us they had 20 payday loans for Cash Converters in a 12-month period, including eight at once."[267] This is not withstanding that, as recognised in the 2019 Senate Inquiry report, ASIC has been active in enforcement:[268] "ASIC points to a good deal of enforcement activity. In particular, it noted that the performance of two firms which had operated under enforceable undertakings, Thorn and Flexigroup, had improved their practices and met their undertakings."

One of the recommendations of the 2019 Senate Inquiry report was the introduction and passage by the Government of the bill that had been earlier prepared by Treasury in response to the SACC review. That bill includes significant reforms targeted at forcing SACC lenders to be more responsible, for example by introducing a protected earnings cap for all borrowers of 10% of net income and introducing broad anti-avoidance protections.

UNITED KINGDOM

Summary of Key Findings

The Financial Conducts Authority (FCA) has undertaken regulation of financial services since April 2013. Responsible lending obligations are in the "Consumer Credit Sourcebook", which covers matters in all lending processes and is updated regularly.[269] Enforcement measures that are available to the FCA and are being proposed in the Credit Contracts Legislation Amendment Bill are suspending or cancelling certification[270] (wording of the New Zealand proposal) or

[265] Credit and Hardship; Report of the Senate Inquiry into credit and financial products targeted at Australians at risk of financial hardship, The Senate, Economics Reference Committee, February 2019 (Senate inquiry),
[266] Senate Inquiry, n255, [3.57].
[267] Senate Inquiry, n255, [3.113].
[268] Senate Inquiry, n255, [3.113].
[269] As of 15/5/2019, the latest update of the Consumer Credit Sourcebook is April 2019.
[270] Credit Contracts Legislation Amendment Bill 2019 (131-1), cl 131P.

suspending firms or individuals from undertaking regulated activities (wording of the United Kingdom law) and withdrawing a firm's authorisation. Although there has not been specific litigation over the responsible lending obligations, there has been much litigation over other aspects of consumer credit. As of July 2017, 1.1 million people in Great Britain are using a form of high cost credit, which is likely to lead to problem debt.[271]

Responsible Lending Obligations

The Financial Conducts Authority (FCA) has regulated financial services in the United Kingdom since 1 April 2013, replacing the Financial Services Authority. The Prudential Regulatory Authority has replaced the Financial Services Authority's role in regulating banks, building societies, credit unions, insurers and major investment firms.[272]

A table outlining the role of the FCA is below:[273]

Financial Conduct Authority (FCA)	
Regulates	• Conduct regulation in retail, wholesale, financial markets and the infrastructure that supports those markets. • Prudential regulation for firms that do not fall in the PRA's scope.
Structure	• Accountable to HM Treasury and Parliament. • Co-ordinated with PRA (as above).
Aims	• Secure appropriate degree of protection for consumers. • Protect and enhance the integrity of the UK financial system. • Promote effective competition.
Approach	• Continue the FSA's conduct requirements without stifling innovation. • Fewer supervisors allocated to specific firms, enabling the FCA to react more quickly. • Judgment required. • Forward-looking. • Recognises the connection between activities in the market and the risks caused by poor conduct. • Prudential perspective: client assets are secure.

[271] StepChange Debt Charity *The high cost of credit: A discussion paper on affordable credit alternatives* (July 2017) at 2.

[272] Kim Durniat "Goodbye FSA, Hello PRA and FCA" (3 April 2013) Barnett Waddingham <www.barnett-waddingham.co.uk> https://www.barnett-waddingham.co.uk/comment-insight/blog/2013/04/03/goodbye-fsa-hello-pra-and-fca/

[273] Kim Durniat "Goodbye FSA, Hello PRA and FCA" (3 April 2013) Barnett Waddingham <www.barnett-waddingham.co.uk> https://www.barnett-waddingham.co.uk/comment-insight/blog/2013/04/03/goodbye-fsa-hello-pra-and-fca/

The FCA has published detailed rules for compliance with all the stages of the lending process, including guidance on responsible lending obligations, in their "Consumer Credit Sourcebook".[274] As part of "the consumer protection objective" of the FCA, the obligations are published to meet "the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question".[275] These rules are made under the authority of sch 17 of the Financial Services and Markets Act 2000, where part 3A of this schedule in s 16E outlines the procedure for the consumer credit rules. This section is inserted into the Financial Services and Markets Act 2000 by an amendment Act, the Financial Services Act 2012, where sch 11, s 26 of this Act amends the financial ombudsman service part of the 2000 Act to say that the authority for consumer credit rules is now with the FCA.[276] The responsible lending obligations are set out in the below paragraphs.

A firm is required to undertake a reasonable assessment of the creditworthiness of a customer before:

1. Entering into a regulated credit agreement;[277] or
2. Significantly increasing the amount of credit provided under a regulated credit agreement; or
3. Significantly increasing a credit limit for running-account credit under a regulated credit agreement.[278]

A creditworthiness assessment also needs to be undertaken where increases in the amount of credit or in the credit limit are not in itself significant, but since the last creditworthiness assessment, would result in a cumulative increase that is significant. For example, a creditworthiness assessment would need to be undertaken where a number of consecutive

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[274] Howard Cohen and Andrew Barber "Consumer credit FCA publishes final detailed rules 2014 march" (3 March 2014) Lexology <www.lexology.com>. https://www.lexology.com/library/detail.aspx?g=2391598c-edc9-4096-9c24-83e251a5251e

[275] Financial Services and Markets Act 2000, s 1C.

[276] Financial Services and Markets Act 2000, sch 17, pt 3A, s 16E, amended by Financial Services Act 2012, sch 11, s 27.

[277] Under s 8(1) of the Consumer Credit Act 1974, a "consumer credit agreement" is an agreement between an individual ("the debtor") and any other person ("the creditor") by which the creditor provides the debtor with credit of any amount. Under s 8(3) of the Consumer Credit Act 1974, a "consumer credit agreement" is a "regulated credit agreement" if it is (a) a regulated credit agreement for the purposes of Chapter 14A of Part 2 of the Regulated Activities Order; and (b) if entered into on or after 21st March 2016, is not an agreement of the type described in art 3(1)(b) of Directive 2014/17/EU of the European Parliament and of the Council of 4th February 2014 on credit agreements for consumers relating to residential immovable property.

[278] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.4].

increases have been made over a period, none of which is significant when considered in isolation, but the aggregate sum of which is significant.[279]

[279] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.6].

The information that must be used for the creditworthiness assessment is:

1. Information of which the firm is aware at the time the creditworthiness assessment is carried out;
2. Obtained, where appropriate, from the customer and where necessary from a credit reference agency.

This information must enable the firm to carry out a reasonable creditworthiness assessment.[280]

The firm must consider:

1. The risk that the customer will not make repayments under the agreement by their due dates (i.e. credit risk); and
2. The risk to the customer of not being able to make repayments under the agreement (i.e. affordability risk).[281]

In considering the customer's ability to make repayments under the agreement, the firm must take into account:

1. The payments as they fall due over the life of the agreement, and where the agreement is an open-end agreement, within a reasonable period;
2. One or more of the following factors:
    a. The customer's income;
    b. Income from savings or assets jointly held by the customer with another person, income received by the customer jointly with another person or income received by another person in so far as it is reasonable to expect such income to be available to the customer to make repayments under the agreement; and/or
    c. Savings or other assets where the customer has indicated clearly an intention to repay (wholly or partly) using them;
3. Whether the customer must borrow to meet the repayments;
4. Whether the customer has another contractual or statutory obligation to meet; and
5. Whether the repayments having a significant adverse impact on the customer's financial situation.[282]

These mandatory creditworthiness assessments are aimed to ensure customer affordability. Based on a reasonable assessment lenders must be able to conclude that the customer can afford to repay a debt at the time they take out the loan and also in the longer term to avoid encountering financial difficulties.[283]

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[280] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.7].

[281] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.10].

[282] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.12].

[283] PwC *Hot topic: New proposed consumer credit lending rules: Customer affordability* (August 2017) at 2.

If the firm can demonstrate that it is obvious that the customer is able to make repayments, or the customer has indicated an intention to repay wholly using savings or other assets, the firm must take reasonable steps to determine the amount, or make a reasonable estimate, of the customer's current income.[284] If the firm wishes to rely on either of these exceptions so that they do not need to estimate the customer's income, the burden is on the firm to demonstrate that the absence of a material affordability risk was obvious such as to make the process of determination or estimate of the customer's income disproportionate.[285]

If it is reasonably foreseeable that a reduction in the customer's income is likely to occur during the term of the agreement, or in the case of an open-end agreement, during the likely duration of the credit, and this could have a material impact on affordability risk, the firm must take reasonable steps to estimate the amount of that reduction. A future increase in the customer's income can only be taken into account where the firm reasonably believes this on the basis of appropriate evidence during the term of the agreement, or during the likely duration of the credit for an open-end agreement.[286] For the purpose of considering the customer's income, it is insufficient for the firm to rely solely on a statement of current income made by the customer without independent evidence, such as information from a credit reference agency or documentation of a third party.[287]

As part of the assessment, the firm must take reasonable steps to determine the amount, or make a reasonable estimate, of the customer's current non-discretionary expenditure during the term of the agreement, or during the likely duration of the credit for an open-end agreement. The firm does not have to determine the customer's non-discretionary expenditure if they can demonstrate that it is obvious in the circumstances of the particular case that the customer's non-discretionary expenditure is unlikely to have a material impact on affordability risk.[288]

If an increase in the customer's non-discretionary expenditure is likely to occur during the term of the agreement, or during the likely duration of credit for an open-end agreement and this increase could have a material impact on affordability risk, the firm must take reasonable steps to estimate the amount of that increase. A decrease in non-discretionary expenditure may only be taken into account if the firm has a reasonable belief that this will occur on the basis of appropriate evidence, and this is likely to happen during the term of the agreement or during the

[284] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.15].
[285] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.16G(1)].
[286] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.16].
[287] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.16].
[288] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.17].

likely duration of the credit for an open-end agreement.[289] Non-discretionary expenditure includes expenditure for other persons whose financial obligations the customer meets wholly or in part.[290]

The extent and scope of the affordability assessment must be reasonable and based on sufficient information and dependent upon, and proportionate to, the individual circumstances of each case. The considerations that the firm must take into account are:

a) The types of information to use in the creditworthiness assessment;
b) The content and level of detail of the information to use;
c) Whether the information in the firm's possession is sufficient;
d) Whether and to what extent to obtain additional information from the customer;
e) Whether and to what extent to obtain information from a credit reference agency;
f) Any other sources of information to use;
g) Whether and to what extent to verify the accuracy of the information that is used;
h) The degree of evaluation and analysis of the information that is used; and
i) The steps to take to determine or estimate the customer's income or non-discretionary expenditure (where such a determination or estimate is required).[291]

Factors to determine whether a more rigorous or less rigorous creditworthiness assessment should be taken are:

a) The type of credit;
b) The amount of the credit or the credit limit;
c) The duration, or likely duration, of the credit;
d) The frequency of the repayments;
e) The amounts of the repayments;
f) The total amount payable;
g) The total charge for credit;
h) The annual percentage rate of charge;
i) Whether the rate of interest or any other charge is fixed or variable;
j) Any other costs which will or may be payable by or on behalf of the customer in connection with the agreement, including charges for non-compliance but excluding charges payable under a hire-purchase agreement;
k) Any other potential adverse consequences for the customer arising under the agreement from a failure to make a repayment by the due date.

[289] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.17].
[290] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.18].
[291] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.20].

The firm may have regard to the purpose for which the customer intends to use the credit. The firm should weigh up the factors before deciding which type of creditworthiness assessment is required.[292] For example, if the amounts of repayment are low and the total charge for credit are low, the amount of information needed to support a reasonable creditworthiness assessment may be less than for a situation where the credit is higher or more expensive, or where the credit is likely to have a significant impact given the customer's financial situation.[293]

The firm should also consider information that they are aware of at the time the creditworthiness assessment is carried out that may indicate that:

a) The customer is in, or has recently experienced, or is likely to experience, financial difficulties; or
b) The customer is particularly vulnerable, for example because the customer has mental health difficulties or mental capacity limitations.[294]

The firm may have regard to information obtained in the course of previous dealings with the customer, however, they should consider whether the information is still valid or needs to be updated given the time passed.[295]

A firm must establish, implement and maintain clear and effective policies and procedures to enable it to carry out creditworthiness assessments and set out the principal factors they will take into account in carrying out creditworthiness assessments. The effectiveness of these policies and the firm's compliance with these policies must be periodically reviewed. [296]

A firm must not complete some or all parts of an application for credit intended to be completed by the customer without the customer's consent or unless that customer has had the full opportunity to check the application before signing the agreement.[297] A firm must not accept an application for credit where the firm knows or has reasonable cause to suspect that the customer has not been truthful in providing the relevant information.[298]

[292] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.20].
[293] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.24].
[294] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.22].
[295] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.23].
[296] Financial Conducts Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.33].
[297] Financial Conducts Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.35].
[298] Financial Conducts Authority *Consumer Credit Sourcebook* (March 2019) at [5.2A.36].

The Consumer Credit Act 2006 made important amendments to the Consumer Credit Act 1974. It was intended for borrowers to have better protection and improved rights and to help consumers by creating a fairer, clearer and more comprehensive credit market. The reforms include the following:[299]

- Section 1 of the 2006 Act changes the definitions of individuals so that it does not include partnerships of more than three members, therefore will not be regulated as consumers, but as bodies corporate for the purposes of consumer credit.
- All consumer credit and consumer hire agreements are regulated regardless of the amount of credit provided, unless they are specifically exempt. In the 1974 Act, the amount of credit provided was regulated if they did not exceed £25,000.
- Section 3 of the 2006 Act provides a special exemption relating to high net worth debtors and hirers who are defined as having a net income of over £150,000. The individual has to agree to the agreement being exempt.
- Section 4 of the 2006 Act retains the £25,000 limit in relation to business purposes in the cases of all lending and hiring.
- The most controversial and important change is to "extortionate credit bargains" under the 1974 Act, which could be reopened if it required the debtor to make payments which were grossly exorbitant or otherwise grossly contravened the ordinary principles of fair dealing. The vast majority of cases found that although interest and other charges were exorbitant, they were not "grossly" exorbitant. Under the new test, the court may consider whether the relationship between the creditor and debtor arising out of the agreement is unfair to the debtor because of the terms of the agreement, the way in which the agreement is operated by the creditor and other things done or not done by the creditor before or after the agreement was made. Once an unfair relationship is found to exist, the court has wide powers in relation to the agreement, including changing the agreement and ordering sums paid by borrowers to be repaid. From 6 April 2008, these provisions apply to all agreements, i.e. apply retroactively.
- Discretion is granted to the courts in choosing whether the grant an enforcement order for regulated agreements. This is a provision which favours lenders. In the 1974 Act prior to amendment, where the execution of an agreement was not compliant with the provisions of the act, the court may not make an enforcement order. Following the amendments, the court will have the power to determine, in its discretion, whether to grant an enforcement order in all cases.

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[299] Slaughter and May *Consumer Credit Act 2006: Amendments to the Consumer Credit Act 1974* (October 2008) at 5.
http://www.slaughterandmay.com/media/760154/consumer_credit_act_2006_amendments_to_the_consumer_credit_act_1974.PDF

- The amendments established an alternative dispute resolution scheme for consumer credit disputes, which is the Financial Ombudsman Service.
- Sections 6 and 7 of the 2006 Act require creditors under fixed-sum agreements to provide debtors with annual statements in a specified form. If there is non-compliance the agreement will be unenforceable.
- Under the 1974 Act, a debtor or hirer who was in arrears could apply to the court for a time order to ask for more time to make their repayments and to reverse the termination of the agreement by the lender.[300] The amendments give much wider rights to the debtor or hirer to go to court to make an application for a time order.
- The amendments require the creditor, upon default by the debtor, to give notice in a specified form, including arrears information, to a debtor 14 days after a time when the debtor is required to have made certain payments.
- The 2006 Act changes the consumer credit licensing regime, in particular, giving the Office of Fair Trading (OFT) a much greater flexibility and discretion in the granting of licences and determining whether the applicant is a fit and proper person. The OFT can require greater information before deciding whether to grant a licence and there is a greater duty to notify changes and information to the OFT. The OFT can impose civil penalties up to £50,000 on persons who do not comply with the requirements imposed by the OFT in connection with the granting of a licence.[301] The functions of the OFT in regulating consumer credit complaints have been transferred to the FCA since 1 April 2014.[302]

Enforcement Measures

The FCA's overriding principle in relation to enforcement is a commitment to achieve fair and just outcomes in response to misconduct. Wrongdoers must be held to account and the rules and requirements must be obeyed.[303] FCA has recognised that severe penalties and sanctions alone are not enough to reduce and prevent serious misconduct, and therefore have increased efficient

[300] Creditfix "When is it Time to use a Time Order?" (15 June 2018) <www.creditfix.co.uk>. https://www.creditfix.co.uk/blog/when-is-it-time-to-use-a-time-order/

[301] Peter Sayer "The Consumer Credit Act 2006: the problems for lenders" (2007) 10 JIBFL 573; Herbert Smith Freehills LLP "Impact of the Consumer Credit act 2006 on the provision of credit products to consumers" (April 2008) <www.lexology.com>. https://www.lexology.com/library/detail.aspx?g=749a3a96-7a51-42bd-acde-699a13fbdf05

[302] Financial Conduct Authority *Consumer Credit Frequently Asked Questions: The transfer of consumer credit to the FCA* https://www.fca.org.uk/publication/consultation/consumer-credit-faqs.pdf

[303] Financial Conduct Authority *FCA Mission: Approach to Enforcement* (April 2019) at 8.

investigations to make detection more likely.[304] The sanction should be sufficient to deter the firm or individual from re-offending and deter others from offending.[305]

FCA will start an enforcement investigation where they suspect serious misconduct. This is assessed by looking at the following factors:

- The nature and severity of the actual and potential harm involved;
- The extent to which the suspected misconduct has or may affect consumers, markets or firms if the FCA does not take action;
- Whether the suspected misconduct has potentially wider or broader implications;
- Whether the suspected misconduct may have involved any lack of fitness or integrity;
- Whether evidence, including witnesses and documents, is likely to be available;
- The public interest in investigating the matter.[306]

Also included in the assessment is whether the firm or individual have taken steps to address the harm and cooperate with the FCA.[307]

Enforcement measures that are available to the FCA are:

- Withdrawing a firm's authorisation;
- Banning individuals from carrying on regulated activities;
- Suspending firms or individuals from undertaking regulated activities;
- Fining firms or individuals who breach our rules or commit market abuse;
- Applying to the Court for injunctions and restitution orders;
- Bringing criminal prosecutions to tackle financial crime.[308]

StepChange Debt Charity's Report on High Cost Lending

In a July 2017 report by the financial counselling charity (the equivalent of budgeting services in New Zealand), StepChange, it was reported that 1.1 million people use a form of high cost credit, including payday/instalment loans, doorstep loans and rent-to-own stores. These people turn to high cost credit to meet essential costs, but the high interest repayments and high fees make these families more prone to debt spirals.[309] Illustrated in the graph below, just under half of

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[304] Financial Conduct Authority *FCA Mission: Our Approach to Enforcement* (March 2018) at 5.

[305] Financial Conduct Authority *FCA Mission: Our Approach to Enforcement* (March 2018) at 13.

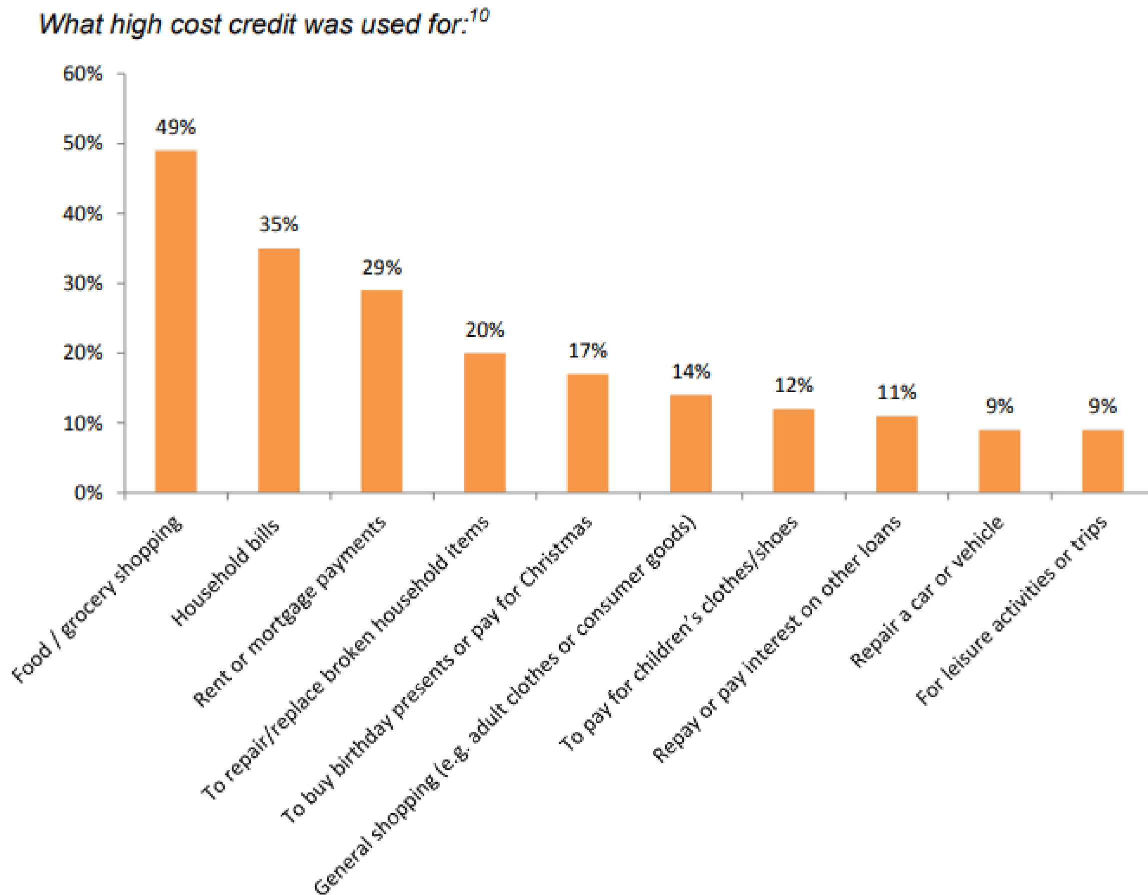
[306] Financial Conduct Authority *FCA Mission: Our Approach to Enforcement* (March 2018) at 10.

[307] Financial Conduct Authority *FCA Mission: Our Approach to Enforcement* (March 2018) at 13.

[308] Financial Conduct Authority *Guide for consumer credit firms* (February 2016) at 43 and 44.

[309] StepChange Debt Charity *The high cost of credit: A discussion paper on affordable credit alternatives* (July 2017) at 2. https://www.stepchange.org/Portals/0/documents/Reports/stepchange-affordable-credit-discussion-paper-july2017.pdf

these high cost credit borrowers use this credit for food and grocery shopping, over a third are using it to cover the costs of essential household bills and over a quarter are turning to high cost lenders to keep up with housing payments.[310] StepChange recommended that the UK "government introduce or underwrite the development of a new scheme for low and no interest loans to help the most financially vulnerable who struggle to safely access any form of commercial credit".[311]



High cost credit borrowers tend to be consumers of lower than average levels of income and have a poor or no credit history that restricts their access to mainstream lenders. High cost credit borrowers are generally separated into two categories: "survival borrowers" and "emergency borrowers".

[310] StepChange Debt Charity *The high cost of credit: A discussion paper on affordable credit alternatives* (July 2017) at 6.

[311] StepChange Debt Charity *The high cost of credit: A discussion paper on affordable credit alternatives* (July 2017) at 3.

- "Survival borrowers" tend to use credit to supplement their income and meet day-to-day essential expenses. They tend to be younger, on persistently low incomes with insecure employment, and receiving benefits.
- "Emergency borrowers" are likely to have experience a recent reduction of their income, called an income shock, or an unexpected cost. Although they have sufficient income for essential costs for day-to-day spending, they tend to have little left for emergencies or discretionary spending. Therefore, high cost credit is used for larger purchases or one-off events.[312]

In 2016, StepChange issued a report on the effect of the new rules on payday lending, by comparing clients who saw StepChange with high cost short-term credit loans in 2013 with clients who saw StepChange with high cost short-term credit loans in 2016. The FCA introduced new rules on payday lending in 2015, which includes:

- A price cap on high cost short-term credit.
- Limits on how many times a payday loan can roll over.
- Stronger guidance on affordability checks and financial health warnings.[313]

StepChange found that less lenders were making excessive use of continuous payment authorities and sending threatening and misleading letters to customers. However, issues still exist where over a third of StepChange's clients with high cost short-term loans have three or more of these loans and three quarters of their clients got a high cost short-term loan when they already had an outstanding loan of this type. Less than half of StepChange's clients received information about free debt advice and a quarter had an affordable repayment plan agreed after telling their lender that they were in financial difficulties. Just over a quarter of clients found that their lenders continued to demand repayment when aware of their financial difficulties, one in five found that their lenders continued to add interest and charges and one in ten were threatened with court or other enforcement action.[314]

The price cap was estimated by the FCA to prevent approximately 160,000 people a year from obtaining high cost short-term credit. StepChange found that a significant gap in the market remains for accessible, affordable credit. People who could not obtain high cost short-term credit after the price cap would look to other providers of the same type of loans, their credit card,

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[312] StepChange Debt Charity *The high cost of credit: A discussion paper on affordable credit alternatives* (July 2017) at 4 and 5.

[313] StepChange Debt Charity "Payday loans: The next generation of high cost short-term credit" <www.stepchange.org.> https://www.stepchange.org/policy-and-research/payday-loans-industry-changes.aspx

[314] StepChange Debt Charity *Payday loans: The next generation* (2016) at 3.

overdraft or home credit loans. These people would miss an essential bill or loan payment or borrowed from friends and family, which seriously constrains their choices.[315]

StepChange reported a change in the high cost short-term make up of their clients after the price cap, where 23% of their clients in the first half of 2013 had obtained this loan, compared to 16% of their clients in the first half of 2015. It was also noted that other reports found a significant reduction in the amount of loans being granted, with 6.3 million loans being granted in the first half of 2013 and 1.8 million loans being granted in the first half of 2015. The average total amount for each loan also decreased, from £1,647 in 2013 to £1,308 in 2016. Since the price cap, a major change in the repayments occurred, where products moved away from a single repayment within 30 days to repayments in instalments over two to 12 months. However, this has the effect of the borrower paying more in total as the interest rate applies to amounts borrowed over a longer period of time. The benefit of these instalment loans is said to have lower weekly repayments, so do not lead to the same extreme debt spiral, but StepChange has still seen clients who struggle with these repayments.[316]

StepChange noted that there were continued problems with lending practices. This was because although a majority of their clients (73%) knew exactly or had a good idea of how much they had to repay under their loan, a quarter of their clients did not know or only had a rough idea of how much they had to repay. The FCA rules require disclosure of the amount of repayments and if it can be determined, the amount in total that has to be repaid,[317] and lenders may not be meeting their disclosure obligations, or that they are providing information that is not easy for the borrower to understand. Over a quarter of StepChange's clients did not think that lenders took reasonable steps to ascertain their ability to make repayments.[318]

Treatment of borrowers in financial difficulties had improved, where 43% of StepChange's clients reported being treated badly by high cost short-term lenders in 2013 and 28% said they were being treated unfairly in 2015. In 2015, 58% of clients told their lender when they got into financial difficulties, and of those clients, 42% were told about free debt advice, 29% had an affordable repayment plan agreed and 28% had the lender offer to freeze interest and charges. The lender continued to demand payment after having been told about the customer's financial difficulties for 24% of these clients.[319]

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[315] StepChange Debt Charity *Payday loans: The next generation* (2016) at 3.
[316] StepChange Debt Charity *Payday loans: The next generation* (2016) at 7, 9 and 10.
[317] Financial Conduct Authority *Consumer Credit Sourcebook* (March 2019) at [4.2.5(2)].
[318] StepChange Debt Charity *Payday loans: The next generation* (2016) at 12.
[319] StepChange Debt Charity *Payday loans: The next generation* (2016) at 16.

The recommendations by StepChange following the report in 2016 of the effects of the price cap are:

1. The FCA should research the implications of moving to instalment loan products.
2. The FCA should make their responsible lending guidance into responsible lending rules.
3. The FCA price cap review should take into account other issues, such as treatment of customers in financial difficulties and come up with ways to address these issues.
4. High cost short-term lenders should ensure loans are based on affordable repayments, with the result that support is available for customers in arrears and debt collection practices are a last resort.
5. The FCA should ensure that regulation across different credit products are consistent so that financially vulnerable consumers are protected.
6. The government needs to come up with affordable, accessible credit for the most financially vulnerable.[320]

Financial Counsellors

Financial counsellors in the UK can provide consumers with advice to make all types of financial decisions, for example, budgeting, handling a debt collector, or obtaining a loan. They can help consumers get their finances on track and help the consumer escape debt. The top free financial counselling services in the UK are:[321]

- *National Debt Line*
  - National Debt Line offer a free online debt advice website through My Money Steps. They also offer a free telephone service for consumers to seek individual financial advice.[322] National Debt Line offers fact sheets, including topics such as types of debt, court action and dealing with creditors, sample letters to send to creditors and budgeting tools.[323]
- *StepChange Debt Charity*
  - StepChange Debt Charity offers a free financial counselling service. The website also has many resources available, such as advice on debt management, debt consolidation, budgeting and housing. They also undertake research into problem

[320] StepChange Debt Charity *Payday loans: The next generation* (2016) at 22 and 23.

[321] Low Income loans Assistance "Free Financial Counselling" <www.lowinomeloansassistance.co.uk>. http://www.lowincomeloansassistance.co.uk/free-financial-counselling/

[322] National Debt Line My Money Steps <www.mymoneysteps.org>.

[323] National Debt Line "Fact sheet library" <www.nationaldebtline.org>. https://www.nationaldebtline.org/S/information/fact%20sheet%20library/Pages/default.aspx

debt in the UK. Services offered include a free online chat service, email services or free advice over the phone.[324]

- *Citizens Advice*
  - This financial counselling service offers online resources, financial advice over the phone and face-to-face meetings with expert financial counsellors. Assistance is available for a range of different issues, such as employment, shelter, debt and numerous financial issues.[325]
- *The Money Advice Service*
  - Financial services offered are via its website, web chat, telephone or face-to-face meeting. Assistance is available for all types of financial issues, including debt, borrowing, budgeting, money management, savings and investing.[326]

UK cases that have arisen from some aspect of consumer lending

1. *McGuffick v The Royal Bank of Scotland* [2010]

This case concerns the effect of s 77 of the then Consumer Credit Act 1974, which rendered the agreement unenforceable in certain circumstances.[327]

On October 3 2005, the claimant entered into a fixed-sum regulated loan agreement with the bank under which the claimant received £17,034 and would repay £20,781 in 60 monthly instalments of £346.35. No payments were made for 10 monthly payments and arrears of £2,078.09 were outstanding on May 16 2007. The bank served a default notice under s 87(1) of the Consumer Credit Act 1974 which requires service of the notice before entitling the creditor to take particular steps. A standard form letter accompanied this which stated that if payment was not made within 28 days of the letter, then information about the claimant's indebtedness would be given to Credit Reference Agencies (CRAs).[328]

At June 2007, the balance outstanding on the claimant's loan account with the bank was £15,066.21. In October, this was referred to a debt collection agency who had no success in recovering the debt despite sending communications to the debtor. A second debt recovery agency was appointed in October 2008, but this also had no success. In February 2009, the

[324] StepChange Debt Charity <www.stepchange.org>.
[325] Citizens Advice <www.citizensadvice.org.uk>.
[326] The Money Advice Service "About us" <www.moneyadviceservice.org.uk>. https://www.moneyadviceservice.org.uk/en/corporate/about-us
[327] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [1].
[328] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [4], [5] and [6].

solicitors for the claimant sent a s 77 information request so that they could obtain a declaration that the agreement was irredeemably unenforceable. They considered the agreement to be in dispute and that no reference was to be made to any credit reference agencies or other regulatory bodies in respect of the agreement and that no enforcement action should be contemplated whilst the agreement was in dispute.[329]

The bank wrote a letter in April 2009 suggesting that the claimant should continue to meet his obligations under the agreement, bearing in mind that it was not void but remained valid and that any continuing default would be reported to the CRAs. It also stated that if the claimant decided not to meet his obligations under the loan, the bank would not be able to enforce repayment of the loan. The defendant bank then followed standard practice when they are unable to enforce the agreement by putting a stop to all collection activity, so as not to give the false impression that it was entitled to obtain a judgment.[330]

The solicitor for the claimant threatened proceedings for a declaration of unenforceability if a copy of the agreement was not produced within 28 days and the bank produced this and stated that recovery action would now continue. The claimant issued proceedings and collection activity by the bank ceased again.[331]

The claimant sought relief for:

a) An injunction restraining the bank from making reports of the claimant's non-payment under the agreement to any of the CRAs.
b) In the alternative, if the bank was entitled to continue such reporting, a mandatory injunction requiring the bank to report additionally to the CRAs that by reason of the bank's breach of s 77, the claimant had no enforceable liability to make payments under the agreement.
c) A mandatory injunction requiring the bank to notify CRAs to whom it had previously reported the state of the claimant's account either (i) that from March 11 2009, the claimant had not been in default of the agreement, or (ii) that from March 11 2009, the claimant had defaulted on the agreement in circumstances where through the bank's breach of s 77, he had no enforceable liability to pay.
d) A mandatory injunction ordering the bank to provide the claimant with a signed statement of account required by s 77(1).[332]

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[329] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [8] and [9].
[330] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [12].
[331] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [14].
[332] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [15].

The issues the Court had to determine were:

- "The effect of an agreement being unenforceable and, in particular, whether it meant that Mr McGuffick had a liability to the bank or whether that liability had been extinguished;
- The meaning of the word "enforcement" under the Consumer Credit Act 1974;
- Whether, during the period of unenforceability, any of the actions taken by the Bank amount to "enforcement" contrary to s 77(4); and
- Whether Mr McGuffick was entitled to an injunction preventing the Bank from reporting his default to CRAs or a mandatory order requiring the Bank to mark, beside the entry, that the Agreement was unenforceable."[333]

The Judge concluded that the effect of unenforceability is that "the rights of the creditor and corresponding liability or obligations of the debtor do exist but are unenforceable, rather than that those rights were never acquired or that the creditor was deprived of those rights whilst the agreement was unenforceable." For the creditor's security rights, they exist but are unenforceable and if there is a court order under s 127(1), then the creditor can enforce its rights under the agreement and in relation to the security. If the court declines to make an order or they are precluded from making an order, then the creditor's rights continue, but cannot be enforced.[334]

The meaning of enforcement was defined as not including the following activities of the creditor:

i. Reporting to CRAs without also telling them that the agreement was currently unenforceable;
ii. Disseminating or threatening to disseminate the claimant's personal data in respect of the agreement of any third party;
iii. Demanding payment from the claimant;
iv. Issuing a default notice to the claimant;
v. Threatening legal action; and
vi. Instructing a third party to demand payment or otherwise to seek to procure payment.[335]

The third to the seventh activities on the list were agreed by the parties that they did not amount to enforcement or actions to enforce the agreement. They were at most, activities that are steps preparatory to subsequent enforcement. Authority supports this as the conclusion was that the bringing of proceedings is only a step taken with a view to enforcement and not actually enforcement.[336] This avoids the issue where if a creditor were to apply to the court for an

[333] Hammonds "First Consumer Credit test Case decided in Bank's Favour" (October 2009) at 1 and 2.
[334] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [67].
[335] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [79].
[336] *Rankine v American Express Services Europe Ltd* [2009] CCLR 3.

enforcement order, they would not be able to because bringing proceedings would be enforcement, which is not permitted without an enforcement order. As the third to the seventh activities were not enforcement, it followed that these activities are not enforcement as they do not amount to steps taken prior to enforcement. At most, it is an attempt by indirect means to persuade the claimant to pay.[337]

As neither reporting to the CRAs during the period of non-compliance, nor any of the steps argued by counsel for the claimant amount to enforcement, the claimant is not entitled to an injunction restraining the bank from continued reporting to the CRAs or from taking any of the other steps.[338]

Counsel for the claimant also alleged a breach of the Data Protection Act 1998 by arguing that the bank has no legitimate interest in passing on information to the CRAs. The Court concluded that the continued reporting to the CRAs during the period of non-compliance was legitimate, did not amount to enforcement and did not require a qualification that the agreement was currently unenforceable, so "there is simply no basis for the contention that the data is not being processed fairly and lawfully". Referral of information could not be prevented under the Data Protection Act 1998.[339]

Arguments of an unfair relationship under the Consumer Credit Act 1974 were also rejected as they rely on the same allegations made under the enforcement aspects of the case, which were rejected.[340]

2. *Mason v Godiva Mortgages Ltd* [2018]

Godiva Mortgages Ltd (Godiva) was a mortgage lender. The Masons engaged the services of an intermediary or broker, named Mr Balm, who offered his services through a number of corporate entities, including Access Business Finance Ltd. With the assistance of Mr Balm, the Masons entered into a regulated mortgage contract with Godiva on 4 February 2008 under which Godiva lent £487,500 on an interest-only basis for a five-year term. The loan was secured on the Masons'

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[337] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [80], [81] and [82].
[338] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [98].
[339] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [112] and [113]; Eversheds Sutherland "High Court decides on legality of referring information to credit reference agencies and clarifies meaning of 'enforcement' in relation to consumer credit agreements" (7 October 2009) <www.eversheds-sutherland.com>. https://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Financial_institutions/consumer_credit_agreements_07Oct09
[340] *McGuffick v The Royal Bank of Scotland Plc* [2009] EWHC 2386 (Comm.); [2010] ECC 11 at [117] and [118].

home. The Masons met all the interest payments during the term of the mortgage, but were unable to repay the capital at the end of the mortgage term.[341]

The Masons argued that Godiva should have never offered them the mortgage because Godiva should have realised that the income figure of £100,000 each for Mr and Mrs Mason stated in the online application form (which Mr Mason says he instructed Mr Balm to remove) was implausible and likely to be false. Therefore Godiva should have known that the mortgage was unaffordable. Godiva argued that it was not offering advice because that was Mr Balm's role. Godiva also contended that none of the Masons' loss could be shown to have flowed from any breach of Godiva's.[342]

The FCA's "Mortgages and Home Finance: Conduct of Business Sourcebook" (MCOB) contains the compliance standards that authorised persons are required to comply with when carrying on the regulated activity of entering into regulated mortgage contracts.[343] This refers to the general principle that "there should be responsible lending, with all underwriting decisions subject to a proper assessment of the borrower's ability to repay and taking full account of the relevant circumstances".[344] In relation to the responsible lending principles, Godiva had the following obligations:

1. Godiva must be able to show that, before deciding to enter into the mortgage, account was taken of the Masons' ability to pay.
2. Godiva can enter into a self-certification mortgage only where they considered it appropriate, having regard to the interests of the customer, and had no reasonable grounds for doubting the information provided.
3. Godiva must have in place, and operate in accordance with, a written policy setting out the factors it will take into account in assessing a customer's ability to repay.[345]

In regards to the first obligation, Godiva met this obligation by having a fraud system in place, not offering self-certified mortgages to first-time buyers. The Masons' stated income was not implausible as their income derived from property development, which plausibly could generate income of the stated amount, especially before the financial crash. Godiva was concerned about the Masons' age, so they required written confirmation that they intended to continue working beyond the age of 75.[346] Godiva had no reason to suspect that the Masons had asked Mr Balm

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[341] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [1] and [2].
[342] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [3] and [4].
[343] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [1].
[344] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [41].
[345] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [52].
[346] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [54].

to remove those figures and that Access Business Finance Ltd was telling the truth when it confirmed that the Masons had been asked to check the application form and confirm the truth of its contents.[347]

For the second obligation, Godiva did not offer self-certification mortgages to first-time mortgagors. The Masons had a previous mortgage with a similar monthly repayment on which they had not defaulted. To Godiva's knowledge, the Masons were being advised by an authorised intermediary who could properly be assumed to have given competent advice.[348]

In regards to the third obligation, Godiva had a policy in place that dealt with self-certification loans, such as loan-to-value ratio and income multipliers. Self-certification products were limited to those who hold a current mortgage in respect of their main residence.[349]

Therefore, there was no breach by Godiva of any of the relevant MCOB rules relating to responsible lending.[350]

3. *Swift Advances plc v Okokenu* [2015]

A fixed sum loan agreement was secured on the defendant's home. The issue in this case was whether the relationship between the claimant creditor and the defendant debtor arising out of the agreement was unfair to the latter.[351] On 14 December 2007, the defendant entered into a fixed sum loan agreement with the claimant secured by way of a second charge on his retirement flat. At the time of the loan, the defendant was 70 years old and unless the defendant could redeem by early repayment, he would be 80 years old before he had paid off the loan. In April 2008, the defendant had entered into another agreement, which meant that repayments would extend until he would be 85 years old. These loans were governed by the Consumer Credit Act 1974.[352]

The defendant rapidly fell into arrears by July 2008 and had made only two of the monthly repayments. He was given a three month grace period but a default notice was served in

[347] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [56].
[348] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [59].
[349] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [60].
[350] *Mason and another v Godiva Mortgages Ltd* [2018] EWCA 3227 (QB) at [63].
[351] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [1].
[352] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [3].

September 2008, possession proceedings were commenced in October 2008 and an order for possession, suspended on terms as to monthly repayments was made on 3 December 2008.[353]

In the application form for the first loan agreement, the defendant stated that his occupation was as a driving instructor and he was receiving income.[354] An income affordability letter for the loan application also stated his weekly income from his occupation as a driving instructor and he also stated that he was working, in a telephone conversation with the claimant's employee. The employee also stated that they were relying on the defendant's statements of his earnings to grant him the loan and warned him of the consequences of securing the loan on his property. The defendant acknowledged these statements.[355] The increase to his loan, which is how the second loan arose, originated by a broker calling the defendant to ask if he wanting to arrange an increase to his existing loan. The broker came to the defendant's house and gave him forms to sign, where he also stated that he is working as a driving instructor, confirmed his weekly income and that he would work beyond retirement age.[356]

In fact, the defendant never found work as a driving instructor. On 9 March 2015, the first day of the hearing, he said that was due to health issues. At the time of the second loan, he was not working as a driving instructor and the statements that he made that he was working and to his weekly income were not correct. The representatives from the credit broker knew that he was not working as a driving instructor.[357]

The defendant argued that it was unfair to lend money to someone who was known to have inadequate income to repay the loan. The law places the responsibility to assess affordability onto the lender because debtors are likely to be desperate and indigent and likely to exercise poor judgment, so are not in a good position to assess their own situation in an objective way.[358]

The court found that nothing about the procedures adopted by the claimant or the terms of the loan agreements entered into were unfair. The procedures of self-certification of income could not be compared to guidance that came into force after the loans were agreed to, even though those procedures were now disapproved of. The claimant was operating in accordance to the then existing guidance. The claimant's answers to the application questions could be described as overoptimistic and confused, or simply untrue, but the relationship between the debtor and

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[353] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [4].
[354] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [11].
[355] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [14] and [15].
[356] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [17] and [18].
[357] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [19].
[358] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [24].

the creditor was perfectly usual and the procedures adopted by the creditor for deciding whether to make a loan to the debtor were entirely conventional in terms of the Office of Fair Trading guidance existing in 2007 and early 2008. [359] This guidance allowed reliance on income self-certification, which fell out of favour with lenders by 2009 because of the world credit crisis. Self-certification relied on the honesty of the borrower's answers and were not audited, but this was conventional for loan practice in 2007 and early 2008.[360]

The claimant was found to not have been unfair to the defendant. The defendant was inconsistent in the accounts he gave, but the failure of the claimant to spot this was understandable and in no way exhibiting carelessness or a failure to achieve a reasonable standard of care. The claimant had proved that the relationship was not unfair, by showing that they were entirely conventional agreements subjected to proper procedures and scrutiny, which did not fall short of any acceptable standard in failing to uncover the defendant's mendacity. The changes to the policy at the time of the hearing could not be taken into account when assessing the unfairness, or lack thereof, of a relationship that arose in 2007 which was subject to different policy guidelines.[361]

4. *Southern Pacific Mortgage Ltd v Green* [2015]

The lender claimant sought possession of the home of the defendant. The issue of disability discrimination arose because the defendant, at all material times, had been severely depressed since the death of a close friend for whom she cared in the last months of her life. The defence of disability discrimination arose initially under the Disability Discrimination Act 1995 and subsequently under the Equality Act 2010.[362]

"The issue is that the defendant contends that the claimant should have acceded to her request to change her mortgage from a repayment mortgage to an interest only one, and that the failure to do so amounted to discrimination against her." The claimant denied that it would be reasonable for them to change the mortgage because the only way the defendant could redeem the mortgage in the end would be to sell her house and that this is too uncertain for either side, therefore it was inappropriate.[363]

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[359] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [44]-[46].
[360] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [6], [35] and [46].
[361] *Swift Advances plc v Okokenu* [2015] CTLC 302 at [47] and [48].
[362] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [2].
[363] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [6].

On 28 August 2006, the defendant re-mortgaged her property and asked for a loan of £96,000. She self-certified income of £32,000. She began to experience financial difficulties and also began to experience depression. The claimant agreed to lend the sum requested and the mortgage was entered into on 13 November 2006 for a term of 20 years, with an interest rate of 5.59% and the property valued at £185,000.[364]

The defendant took out insurance to cover her repayments should she be unable to make payment and claimed this on the basis on unemployment and later, on the basis of her diagnosis. The insurance ran out on 17 November 2008 and she was unable to meet her full liability under the mortgage for the payment from the capital each month plus a payment of interest.[365]

By the time the claim was issued on 26 March 2009, the claimant was aware that the defendant was disabled and unable to find work. The claimant gave no thought to the defendant's position as a disabled person. The claimant had also applied for Department of Work and Pensions (DWP) payments, who through its "Support for Mortgage Interest" scheme will meet the interest payments of a person in receipt of various benefits at a set interest rate. The payments would have met the interest payment and had extra for the defendant because the rate payable was lower than the rate met by the DWP. However, as the DWP payments had been applied for and not yet given, these observations are in hindsight, but the claimant should have known that it was very likely if not certain that the defendant would qualify.[366]

The crucial question was whether the claimant should have taken into consideration the defendant's request to change the mortgage from repayment to interest only, before starting possession proceedings.[367] The defendant did not request transfer to an interest only mortgage before proceedings commenced, but the request came shortly after proceedings were started. After proceedings commenced, the claimant did not give much thought, if any, to the possibility of stopping and compromising, even when aware of the defendant's disability.[368] On 3 July 2009, in a letter, the claimant refused to convert the mortgage to an interest only basis without justification and they did not mention the defendant's disability nor the DWP interest. This was refused again on 10 August 2009.[369]

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[364] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [7] and [8].

[365] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [9]; LPC Law "Disability discrimination in possession claims" (5 February 2016) <www.lpc-law.co.uk>. https://www.lpc-law.co.uk/news/latest-news/2016/february/disability-discrimination-in-possession-claims/

[366] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [14] and [15].

[367] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [17].

[368] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [19].

[369] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [21] and [22].

On 22 December 2011, the Financial Services Ombudsman gave a ruling on the claimant's refusal to convert the mortgage to interest only and recommended that there be an interest only period of 9 months. The claimant has not put this in place.[370]

The Court found that the lender did not discriminate against the defendant in deciding to commence possession proceedings, they treated the defendant no less favourably than anyone else in arrears.[371]

To consider whether the refusal to transfer the mortgage to an interest only mortgage was discriminatory, the Judge noted that the claimant was aware that the defendant was ill, that DWP payments were probably going to be made and what interest rate would be paid by the DWP.[372] The next question for the Judge to consider was whether the effect of the failure to allow a switch from repayment to interest only makes it "impossible" or "unreasonably difficult" for the disabled person, (the defendant herself) to make use of the "services" offered, which is defined as being the entire life of the mortgage. It was possible for the defendant to redeem the mortgage at the end, but at present she could not make repayments. The redemption of the mortgage could leave the defendant homeless and destitute, but the transfer to an interest only mortgage would not have any impact on the defendant's ability to redeem the mortgage at the end of the term.[373]

The defendant argued that the change to an interest only mortgage would be a reasonable adjustment that the mortgage company should have made.[374] This argument was unsuccessful. To determine this, the Judge referred to precedent for the meaning of "adjustment to services", which held that this did not require the provider to take steps that would fundamentally alter the nature of their service.[375] The interest only mortgage was not a reasonable adjustment under s 21 of the Disability Discrimination Act 1995 when the defendant proposed it in 2009. This is because the repayment plan was speculative, the period of the mortgage was 20 years where house prices may fluctuate and the security is speculative and precarious.[376] There was no time where it was a reasonable step for the lender to forgo its security, having regard to the defendant's disability.[377]

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[370] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [25].
[371] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [59].
[372] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [62].
[373] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [66].
[374] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [60].
[375] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [69]; *Edwards v Flamingoland Ltd* [2013] EWCA Civ 801.
[376] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [71].
[377] *Southern Pacific Mortgage Ltd v Green* 2015 WL 7692940 (2015) at [72].

Therefore, the conclusion was that the claimant was entitled to the possession of the property.[378]

The case was appealed to the Court of Appeal, who dismissed the appeal and followed the same reasoning as the County Court.[379]

5. *Carney v NM Rothschild & Sons Ltd* [2018]

The defendant, NM Rothschild & Sons Ltd (the Bank) entered into loan agreements (the Loan Agreements) with the claimants, British expatriates living in Spain, on or about 13 March 2006 and 3 November 2005. The Bank advanced £292,500 to Mr and Mrs Carney (the Carney Loan) and £750,000 to Mr and Mrs Fox (the Fox Loan). The loans, secured against their properties, was to enable them to enter into investments designed to reduce the Spanish equivalent of inheritance tax. They engaged the services of an independent financial adviser throughout the process.[380]

The Loan Agreements were all in the same form and contained clauses to the effect that Rothschild had made no recommendations as to the suitability of the investments and had acted as provider of finance only, and that the claimants had been advised to seek independent legal and tax advice.[381] "The investments underperformed and the claimants sued the bank for their loss, alleging that the bank had given them the wrong advice, and made serious misrepresentations about the investments and tax implications."[382]

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[378] LPC Law "Disability discrimination in possession claims" (5 February 2016) <www.lpc-law.co.uk>. https://www.lpc-law.co.uk/news/latest-news/2016/february/disability-discrimination-in-possession-claims/

[379] *Green v Southern Pacific Mortgage Ltd and Equity & Human Rights Commission* [2018] EWCA Civ 854, [2018] All ER (d) 94 (Apr).

[380] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [1] and [2]; Sophie Walker "Bank's basis clauses upheld in unfair relationship claim" (21 June 2018) Allen & Overy <www.allenovery.com>. http://www.allenovery.com/publications/en-gb/Pages/Bank%E2%80%99s-basis-clauses-upheld-in-unfair-relationship-claim.aspx

[381] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [36] and [37]; Laura Berry "Carney and Parmar – further comfort for banks facing mis-selling claims, and a word of warning about witness evidence" (29 June 2018) Dac Beachcroft <www.dacbeachcroft.com>. https://www.dacbeachcroft.com/en/gb/articles/2018/june/carney-and-parmar-further-comfort-for-banks-facing-mis-selling-claims-and-a-word-of-warning-about-witness-evidence/

[382] Sophie Walker "Bank's basis clauses upheld in unfair relationship claim" (21 June 2018) Allen & Overy <www.allenovery.com>. http://www.allenovery.com/publications/en-gb/Pages/Bank%E2%80%99s-basis-clauses-upheld-in-unfair-relationship-claim.aspx

The sole claim by the claimants is under ss 140A and 140B of the Consumer Credit Act 1974 that an unfair relationship arose between the claimants and the Bank out of the loan agreements, the principal relief of which is the removal of their indebtedness to the Bank under the loan agreements and the discharge of security.[383] The particular allegations by the claimants were that the Bank:

a) Misadvised them on the suitability of the investment, its risks and the tax efficacy of the scheme;
b) Made a series of serious misrepresentations about the investment and its tax position;
c) Were in breach of a number of regulatory codes, principles and FCA publications;
d) Failed to provide enough information about the investment provider; and
e) Failed to provide it with risk warnings over the performance of the investment.[384]

The Court found that the law of unfair relationships in consumer credit agreements was summarised by the Supreme Court in *Plevin v Paragon Personal Finance Ltd*.[385]

1. What must be unfair is the relationship between the debtor and the creditor.
2. Although the court is concerned with hardship to the debtor, ss 140A(2) envisages that matters relating to the creditor or the debtor may also be relevant. There may be features of the transaction which operate harshly against the debtor, but it may not necessarily be unfair as it may be a legitimate interest of the creditor.
3. The alleged unfairness must arise from one of the three categories of cause under s 140A(1)(a) – (c), which include the terms of the agreement, the way the creditor has exercised or enforced any of his rights under the agreement, or any other thing done, or not done by, or on behalf of the creditor.
4. The great majority of relationships between debtors and creditors are characterised by large differences of financial knowledge and expertise, but it cannot have been Parliament's intention to allow the transaction to be reopened on reasons of the generality typical of these relationships.

[383] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [16].
[384] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [12] and [13]; Addleshaw Goddard ""Unfairness" under the Consumer Credit Act 1974: Carney v NM Rothschild & Sons Ltd [2018] EWHC 958 (Comm)" <www.addleshawgoddard.com>. https://www.addleshawgoddard.com/en/insights/insights-briefings/2018/litigation/unfairness-under-the-consumer-credit-act-1974-carney-v-nm-rothschild--sons-ltd-2018-ewhc-958-comm/
[385] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [46]; *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625.

Under s 140A(1)(a), factors relevant to determine whether an unfair relationship exists on the terms of the agreement are:

a) Whether the term is commonplace and/or in the nature of the product in question;
b) Whether there are sound commercial reasons for the term;
c) Whether it represents a legitimate and proportionate attempt by the creditor to protect its position;
d) To the extent that a term is solely for the benefit of the lender, whether it exists to protect him from a risk which the debtor does not face;
e) The scale of the lending and whether it was commercial or quasi-commercial in nature;
f) The strength of the debtor's bargaining position; and
g) Whether the terms have been individually negotiated or are pro forma terms, and if so, whether they have been presented on a "take it or leave it" basis.[386]

Conduct before the agreement is also relevant under s 140A(1)(c):

a) Whether the creditor applied any pressure on the borrowers to execute the agreement (if an agreement has been entered into with a sense of urgency it will be relevant to consider to what extent responsibility for this lay with the debtor, as distinct from the creditor);
b) Whether the creditor understood and had reasonable grounds to believe that the borrower had experience of the relevant arrangements and had available to him the advice of solicitors;
c) Whether the creditor had any reason to think that the debtor had not read or understood the terms;
d) Whether the debtor demurred at the time of formation over the terms they now suggest are unfair (this point has particular force if they did complaint over other terms).[387]

On the facts, the Judge found that the Bank had given no material advice in respect of the investment, nor had it assumed an advisory role. There was no giving of advice as the claimants had a separate financial adviser involved and it is unlikely there would be two advisers to the claimant.[388]

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[386] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [55]; *Deutsche Bank (Suisse) SA v Khan* [2013] EWHC at [345].

[387] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [56]; *Maple Lead v Rouvroy* [2009] 2 All ER 287 at [274].

[388] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [339]; Addleshaw Goddard ""Unfairness" under the Consumer Credit Act 1974: Carney v NM Rothschild & Sons Ltd [2018] EWHC 958 (Comm)" <www.addleshawgoddard.com>. https://www.addleshawgoddard.com/en/insights/insights-briefings/2018/litigation/unfairness-under-the-consumer-credit-act-1974-carney-v-nm-rothschild--sons-ltd-2018-ewhc-958-comm/

This was the first case that considered basis clauses under the provisions for unfair relationships. Basis clauses differ from exclusion clauses (which are subject to statutory control) because they merely define the parties' obligations or duties toward each other, rather than excluding a liability that might otherwise exist.[389] Basis clauses are still able to be analysed to give rise to an unfair relationship, but their impact on the issue of an unfair relationship is much less than if they had been found to be exclusion clauses.[390] The question of whether a clause is a basis clause or an exclusion clause must have regard to the following factors:

1. The natural meaning of the language of the clauses in their contractual context;
2. The particular factual context in which the agreement containing those clauses was made;
3. The format and location within the contract of the clause and whether it was simply one of a myriad of standard terms may point to it being exclusionary.

The relative bargaining power of the parties is not particularly relevant to this question.[391]

In this case, the clauses used by the Bank were not exclusion clauses because:

1) The language was not expressly that of exclusion of liability, but rather the absence of any advice that could give rise to it;
2) There were other clear indications the relationship was not advisory;
3) The terms affirmed history, rather than rewriting it;
4) The terms were not found within a myriad of standard terms.[392]

Even if the clauses were exclusion clauses, the Court concluded that they would be manifestly reasonable mainly because:

1) They were clearly stated;
2) They were proportionate attempt by the Bank to limits its exposure to a wider role and it was in their legitimate interest;
3) All of the claimants were able to understand and Mr Carney in particular was familiar with these types of clauses from his business experience;
4) There was no pressure from the Bank on the claimants to enter the loan;

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[389] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [73]; Gough Square Chambers "'Carney v Rothschild' Unfair Relationships Case" (11 May 2018) <www.goughsq.co.uk>. https://goughsq.co.uk/carney-v-rothschild-unfair-relationships-case/?hilite=%27carney%27%2C%27rothschild%27

[390] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [100].

[391] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [94]; Sophie Walker "Bank's basis clauses upheld in unfair relationship claim" (21 June 2018) Allen & Overy <www.allenovery.com>. http://www.allenovery.com/publications/en-gb/Pages/Bank%E2%80%99s-basis-clauses-upheld-in-unfair-relationship-claim.aspx

[392] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [347].

5) The Bank should not be seen or treated as giving advice because of independent financial advisers;

6) There was already a relationship between the claimants and an independent adviser.[393]

Therefore, the claims were dismissed and there was no element of unfairness between the parties.[394]

6. *Aurora Leasing Limited v Colliers International Belfast Limited* [2013]

The plaintiff's claim was for damages for loss and damage alleged to have been sustained by reason of the professional negligence of the defendant as surveyors and valuers who completed a valuation of property for the purposes of a loan proposed to be made by the plaintiff to Rippington Bristow Ltd (Rippington) with personal guarantees provided by the Campbells and security provided by the property owned by the guarantors, being the property the subject of the defendant's valuation.[395]

On 7 May 2009, the plaintiff advanced to Rippington the sum of £901,000 repayable by 59 monthly instalments, making a total repayment of £1,289,000 to include interest, this loan was based on valuations made by the defendants. The loan was secured by the guarantees of the Campbells' property, which was subject to a prior mortgage of approximately £2M.[396] Before the loan was made, a valuation in January 2008 by the defendants valued the property at £4.5M and another valuation was made in August 2008 which valued the property at £5M. Rippington defaulted on the repayments and the Campbells did not make any payment on the guarantees. The Campbells were declared bankrupt and Rippington was placed into compulsory liquidation.[397]

Negligence was found by the Judge as there was a significant overvaluation of the property, of which at April 2009 would be £3M - £3.75M. If there was no overvaluation of the property, the plaintiff would not have advanced the loan at all, therefore the breach caused the loss. The value recoverable was the £901,000 of the initial loan less the payments made by Rippington.[398]

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[393] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [348]; Jolyon Connell "Fair enough? Basis clauses in bank's contract challenged as unfair terms" (12 September 2018) Farrer & Co <www.farrer.co.uk>. https://www.farrer.co.uk/news-and-insights/fair-enough-basis-clauses-in-banks-contract-challenged-as-unfair-terms/

[394] *Carney v NM Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 2018 WL 02009992 at [349].

[395] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [1].

[396] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [2].

[397] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [3].

[398] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [32].

However, contributory negligence on the part of the plaintiff was alleged to reduce the damages that should be made to the plaintiff. This is because although the negligent valuation caused loss to the plaintiff, the plaintiffs acted imprudently in advancing the loan because they did not make adequate inquiries as to the circumstances of the borrower and the guarantors and the property that was to provide security.[399]

Expert evidence was provided to say that the risk profile of the mortgage application was high given the large amount of the loan, the high value property, falling house prices, the absence of credit search, the absence of mortgage history, the absence of company accounts, the absence of confirmation of income and the absence of confirmation of planning consent.[400] Lending industry standards should have been applied to the plaintiff's lending, including the responsible lending obligations which requires a proper assessment of the borrower's ability to repay. Complaints about the plaintiff's conduct include a lack of protocol for lending on residential property, no adequate searches carried out against the Campbells or the company, alleged red flag items which demanded further inquiry, proceedings by HSBC and a bankruptcy petition against Mr Campbell were initially undisclosed, searches revealed charges against the company that were not disclosed and the viability of the company was in question. Also, the plaintiff expressed exasperation with the introducing agent about the difficulty in extracting information in relation to the Campbells and the company.[401]

It was noted that the transaction concerning the loan was not a traditional residential mortgage arrangement and the plaintiff was not generally involved in this market as this was only the second loan secured on property undertaken by the plaintiff.[402]

The defendant's valuation provided a substantial cushion to the plaintiff and it was intended by the plaintiff that they should maintain such a cushion. The protection by the plaintiff was sought through the significant cushion, rather than relying on the security of inquiring about the capacity to repay.[403] The plaintiff ought to have made further inquiries as to the circumstances of the Campbells and the company. They should have followed up on warning signs arising from the failure to disclose certain information. Therefore, the plaintiff did not take all the measures that

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[399] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [34].

[400] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [35].

[401] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [36].

[402] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [37]; RG Sinclair Solicitors & Co Ltd "Lender succeed in valuer's professional negligence case" (9 April 2015) <www.rgsinclair.co.uk>. https://rgsinclair.co.uk/professional-negligence-case/

[403] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [41].

a reasonably prudent lender should have taken, so contributory negligence was assessed at 20% and reduced the total amount recoverable.[404]

7. *Grace v Black Horse Ltd* [2014]

On 2 September 1997, the first appellant Mr William Grace bought his grandson a laptop by entering into a hire purchase agreement with Chartered Trust PLC (CTP), which was the predecessor in title of the respondent, Black Horse Ltd. This was a regulated agreement under the Consumer Credit Act 1974 and s 63 required the lender to supply the borrower a copy of the agreement. However, there were material differences as to the interest rate and APR in the copy given to Mr Grace from the copy that he signed. This meant that under s 63(5), the agreement was not properly executed.[405] The result of this was that the agreement was permanently unenforceable against Mr Grace.[406]

Mr Grace fell into arrears after closing the account from which direct debit payments were being made. CTP imposed penalty charges and Mr Grace refused to make any further payments. CTP brought proceedings against Mr Grace and obtained a default judgment which was registered against Mr Grace with credit reference agencies (CRA).[407]

The unenforceability of the agreement came to light during the proceedings, which meant that the default judgment was set aside, CTP's claim was dismissed with costs and CTP gave an undertaking to remove the default judgment, which they complied with three years after the hearings. However, CTP added the costs amount to the amount of Mr Grace's debt and wrote off the debt, but filed an entry with CRAs in May 2000 that Mr Grace had defaulted on the debt including the costs.[408]

Mr Grace found out about the default registration late 2003 and pursued his complaint with CTP, who by then was known as Black Horse Ltd. Black Horse vacated the default registration with the CRAs on 5 January 2004. Mr Grace's claim is that, in the meantime, the existence of the default registration had caused him to be unable to obtain banking facilities and that this disability persisted, even after the removal of the default registration, until October 2004.[409]

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[404] *Aurora Leasing Ltd v Colliers International Belfast Ltd* [2013] NIQB 116 at [42].
[405] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [1].
[406] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [2].
[407] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [3] and [4].
[408] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [5] and [6].
[409] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [7].

In the meantime, Mr Grace's partner, Mrs George, had entered into a separate hire purchase agreement for the purchase of a static caravan, incurring an APR of 17.9%. The higher APR was as a result of the default registration of Mr Grace.[410] On 14 December 2009, Mr Grace and his partner issued a claim seeking damages for breach of statutory duty by Black Horse under s 13 of the Data Protection Act 1998, upon the basis that the default registration involved a contravention of the Data Protection Principles which had caused each of them damage, in his case due to his inability to obtain satisfactory banking facilities and, in her case, due to the increased APR which she incurred under the 2003 agreement. Mrs George had fallen into arrears on payments.[411]

In prior proceedings, the appellants' claims were dismissed on two grounds:

1. The whole of Mrs George's claim and all of Mr Grace's claim other than the loss due to inadequate baking facilities, was statute barred.
2. Although the default registration had involved a breach of the Data Protection Principles and had been the cause of their alleged loss, the loss was not attributable to the breach of the principles.[412]

For Mr Grace's claim, the Judge concluded that it was inaccurate to describe Mr Grace as a defaulter under his hire purchase agreement once a court had decided that it was irremediably unenforceable against him.[413] Therefore, to the extent that Mr Grace's claim was not statute barred, the breach of the Data Protection Act constituted by the default registration did cause the alleged loss.[414]

Mrs George's claim failed because the judge at first instance was lawful in ordering the delivery up of the caravan and Black Horse Ltd could take possession of the caravan.[415]

8. *Plevin v Paragon Personal Finance Ltd* [2013] EWCA and [2014] UKSC

The judgment dealt with the *Plevin* case as well as *Conlon v Black Horse Ltd* because they both raised issues under s 140A of the Consumer Credit Act 1974 in the context of the selling of single-premium Payment Protection Insurance (PPI) in connection with the lending of money under a credit agreement. Section 140A provides for the power of the Court to make an order in

[410] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [8]; Georgina Squire, Rosling King LLP
[411] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [9].
[412] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [15].
[413] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [41].
[414] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [44].
[415] *Grace v Black Horse Ltd* [2014] EWCA Civ 1413, [2014] GCCR 12125 at [50] and [51].

connection with a credit agreement if the Court determines that the agreement created a relationship unfair to the debtor because of any of the terms, the way the creditor exercised or enforced their rights, or any other thing done by, or on behalf of the creditor. These cases also raised questions as to the ambit and effect of *Harrison v Black Horse Ltd* (*Harrison*).[416]

In *Conlon v Black Horse Ltd*, the credit agreement and associated PPI were entered into on the 3rd and 4th of April 2007. The amount lent was £17,500, to which was added the PPI single premium of £3,347.46. Leaving aside the PPI, the effect of the transaction was to repay the balance of two outstanding loans, and to provide an additional £1,267.26 to Mrs Conlon. Both the earlier loans had themselves been the subject of single premium PPI, so that those policies were both terminated early, along with their associated loans. Early termination of PPI gives rise to notoriously poor rates of premium refund.[417]

More than 40% of the premium was received by Black Horse as commission. Since the premium was itself lent to her by Black Horse, she would also be paying interest to Black Horse on the part of it which constituted that commission. It was accepted that if Mrs Conlon had known she would be paying Black Horse's commission with interest, she would have shopped around and searched for a cheaper quotation.[418]

It was found that the decision of Black Horse to withhold the facts about the commission would bring them valuable commercial advantages, but it ran contrary to good ethical practice and in considering fairness, it was no answer to say that the defendant was not obliged to make such disclosure in law or by industry standards. Mrs Conlon was entitled to know what she was paying for.[419] However, this was not a relevant point of distinction between Mrs Conlon and the decision in *Harrison*. Mrs Conlon's claim failed because *Harrison* decided that it would be anomalous if a lender could be found to have created an unfair relationship, where there was no breach of the relevant regulatory regime, in relation to a point (whether or not to require disclosure of commission) specifically considered and decided by the framers of that regime. Mrs Conlon did not do or say anything to set herself apart from customers to whom the existence and amount of the commission was a matter of indifference. The Insurance Conduct of Business Rules (ICOB) regime did not require Black Horse to disclose the existence or amount of commission to its customers generally.[420]

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[416] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 211 and 212; *Harrison v Black Horse Ltd* [2011] WCA Civ 1128.
[417] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 213.
[418] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 214.
[419] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 214.
[420] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 216.

The Supreme Court in this case noted that both the Recorder (initial trial) and the Court of Appeal were bound by the decision of *Harrison* and expressed dismay at the outcome. Although the Supreme Court were commenting on *Harrison* in reference to the dismissal of Mrs Plevin's claim of non-disclosure, *Harrison* was the relevant authority used to dismiss Mrs Conlon's claim as well. The Supreme Court criticised *Harrison* saying that the Recorder and the Court of Appeal's "dismay was justified" and that "*Harrison* was wrongly decided".[421]

In *Plevin v Paragon Personal Finance Ltd*, Mrs Plevin was a 61 year old widowed college lecturer, teaching hair and beauty, when she entered into a credit agreement with Paragon on 21st March 2006. She lived on her own in a house which she had shared with her late husband. She had a mortgage and various unsecured personal debts in the form of loan and credit card borrowing. She wanted both to consolidate those debts and make some home improvements. She received an unsolicited leaflet from an independent finance broker, LL Procession (UK) Ltd (LLP). LLP is regulated by ICOB in relation to insurance products and a member of the Finance Industry Standards Association (FISA) therefore are subject to self-regulatory codes and disciplinary procedures, in relation to acting as a broker in lending transactions. The pamphlet advertised its ability to "wrap up" a customer's existing liabilities into a "LoanLine loan" at a competitive interest rate over a long term and offered to anyone who completed the application form "the finance plan that's right for you".[422]

Mrs Plevin phoned LLP on 24th February 2006 and LLP conducted a form of demands and needs assessment over the telephone, noting the important points on an internal standard form. This included an insurance policy. LLP's sent Mrs Plevin a recommendation of a finance plan three days later, which suggested that Mrs Plevin should take out a £34,000 loan from Paragon repayable over ten years, and the loan of an additional £5,780 to pay for the five year PPI. The letter noted that it provided protection against inability to work because of sickness or accident and redundancy, and proffered an optional life cover in addition. Paragon was one of a number of lenders on LLP's books.[423] Of the PPI premium, the underwriter Norwich Union received only £1,630, LLP was paid £1,870 and Paragon received a commission of £2,280. The commission element of the premium was 71.8%, which is substantially in excess of the real cost of the PPI.[424]

Mrs Plevin completed and signed LLP's standard application form on 6th March and sent it to LLP, which forwarded it to Paragon. A Paragon employee phoned Mrs Plevin for the "Speak With"

[421] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [16].
[422] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 218.
[423] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 218.
[424] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 219.

process, which enabled Paragon to ascertain directly from Mrs Plevin that she wished to obtain a loan and associated PPI on the terms proposed to Paragon by LLP. There was no separate appraisal by Paragon of Mrs Plevin's demands and needs, or the suitability of the loan for her purposes. The transaction was completed on 21st March 2006. The lack of separate appraisal of Mrs Plevin's needs was relevant because Mrs Plevin alleged that she already had sickness and redundancy cover because of her employment and life insurance and had no dependents living with her. There was no need to protect dependents from eviction by enforcement of Paragon's security, so life cover may not have been suitable at all. Also, Mrs Plevin was given a "cashback certificate" promising repayment of the whole of the PPI premium to her if, for the whole of the ten year period of the loan, she punctually paid every instalment due. [425]

Mrs Plevin alleged that an unfair relationship existed between her and Paragon within the meaning of s 140A of the Consumer Credit Act 1974. The dispute was over the meanings of "on behalf of", as in a relationship could be unfair because of "any other thing done (or not done) by, or on behalf of, the creditor".[426]

The differences in the submission was that for Paragon, it was submitted that "on behalf of" is designed to only capture conduct for which the creditor can be said to bear or share some responsibility, whereas for Mrs Plevin, the meaning was that it captures all conduct beneficial to the creditor, in the sense that it played some material part in the bringing about of the transaction giving rise to the allegedly unfair relationship.[427]

The broad interpretation was chosen by the Court of Appeal as better serving the statutory purpose of ss 140A and B. This was because the broad interpretation brought the conduct into the scope of the Court, but left the Court free to consider its causative effect and the Court's discretion whether to grant relief still remained after having analysed all the conduct beneficial to the creditor.[428]

The Finance Industry Standards Association[429] provisions do not allocate responsibility between members and their intermediaries in relation to lending transactions. The Financial & Leasing

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[425] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 219.
[426] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 220 and 211.
[427] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 222.
[428] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 225.
[429] The Financial Industry Standards Association (FISA) was a self-regulatory and standards body in the secured loans market. FISA regulated both lenders and brokers until April 14 2009. After this date, the lender activities of FISA are carried out by the Finance and Leasing Association, whereas the broker activities of FISA are looked after by the Association of Finance Brokers. See Mortgage Strategy "Secured loans industry loses its standards body

Association (FLA) Code and monitoring obligations impose continuing responsibilities on lenders which are not discharged by simply leaving the whole of any relevant assessment, or other regulatory compliance, to an intermediary broker.[430]

On appeal, the Supreme Court considered that the non-disclosure of the commissions payable out of Mrs Plevin's PPI premium made her relationship with Paragon unfair because there was a sufficiently extreme inequality of knowledge and understanding. Mrs Plevin must be taken to have known that some commission would be payable to intermediaries out of the premium before it reached the insurer, but commissions may become so large that the relationship cannot be regarded as fair if the customer is kept in ignorance. If Mrs Plevin had known that 71.8% of the premium would be paid out in commissions, she would have "certainly questioned this" and may have chosen not to take PPI at all. The fact that she was left in ignorance made the relationship unfair.[431]

The next question which was considered was whether that state of affairs arose from something done or not done by or on behalf of Paragon. Paragon owed no legal duty to Mrs Plevin under the ICOB rules to disclose the commissions and not being her agent nor adviser, they owed no such duty under the general law either. But, the question that arose under s 140A(1)(c) was whether the unfairness arising from the non-disclosure was due to something done or not done by Paragon, and not whether there was a legal duty to disclose the commission. The creditor must be responsible for an omission making his relationship with the debtor unfair if he fails to take such steps as (i) it would be reasonable to expect the creditor or someone acting on his behalf to take in the interests of fairness, and (ii) would have removed the source of that unfairness or mitigated its consequences so that the relationship as a whole can no longer be regarded as unfair.[432] The unfairness arising from the non-disclosure of the amount of the commissions was the responsibility of Paragon because they were the only party who must necessarily have known the size of both commissions. It would have been reasonable to expect Paragon to disclose given the significance for Mrs Plevin's decision. If Paragon disclosed, Mrs Plevin would have been able to make a properly informed judgment about the value of the PPI policy, which is demonstrated by her evidence that she would have questioned the commissions had she known about them.[433]

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after 30 years" (30 March 2009) <www.mortgagestrategy.co.uk> https://www.mortgagestrategy.co.uk/issues/30-march-2009/secured-loans-industry-loses-its-standards-body-after-30-years/

[430] *Plevin v Paragon Personal Finance Ltd; Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2013] CTLC 209 at 227.

[431] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [18].

[432] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [19].

[433] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [20].

As LLP was the intermediary who made the personal recommendation to Mrs Plevin, LLP had to ensure that the personal recommendation was suitable for the customer's demands and needs. Paragon was not obliged and did not owe any other legal duty to assess Mrs Plevin's needs and advise her on the suitability of PPI for her. From this, the judge considered that it was unreasonable to expect Paragon to assess Mrs Plevin's needs themselves because there was no statutory duty for them to do so and this was expressly assigned to the intermediary. The second issue was whether LLP, who had a regulatory duty to assess Mrs Plevin's needs, were acting on behalf of Paragon for the purpose of s 140A(1)(c).[434] The Supreme Court disagreed with the Court of Appeal by confining "on behalf of" to agency and deemed agency relationships, rather than anyone who played some part in the bringing about of the credit agreement for the creditor.[435] However, it was noted that once *Harrison* was discarded s 140A could be interpreted to give extensive protection to the debtor extending beyond the right to enforce the creditor's legal duties, in any situation where the creditor or his associates (or agents) have made the relationship unfair. This would have to be judged against the more limited liability that lenders are deemed to have for third parties.[436]

Therefore, the non-disclosure of the amount of the commissions made Paragon's relationship with Mrs Plevin unfair. This was enough to justify the reopening of the transaction under s 140A. The appeal was dismissed on different reasoning to the Court of Appeal and remitted back to the County Court to determine relief.[437]

9. *Webb Resolutions Ltd v. E.Surv Ltd* [2012]

In 2006 and 2007, GMAC RFC Ltd (GMAC) were the largest centralised mortgage lenders in the UK. The defendant, E.Surv, was the largest residential surveyor in the UK. GMAC regularly used E.Surv to carry out mortgage valuations on residential properties. GMAC alleged that some of those valuations carried out in 2006 and 2007 were performed negligently and/or in breach of contract. GMAC assigned their claims against E.Surv to Webb Resolutions Ltd (Webb).[438]

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[434] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [24] and [26].

[435] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [30]; Eversheds Sutherland "Plevin – what are the implications of this long awaited Supreme Court decision?" (17 November 2014) <www.eversheds-sutherland.com>. https://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Financial_institutions/Plevin_v_Paragon

[436] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [34].

[437] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625 at [41]; Samuel Sherwood "Case Comment: Plevin v Paragon Personal Finance Ltd [2014] UKSC 61" (11 December 2014) UKSC Blog <www.ukscblog.com>. http://ukscblog.com/case-comment-plevin-v-paragon-personal-finance-limited-2014-uksc-61/

[438] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 256.

The damages claim was modest in the two valuations that are the concern of the case, which were £24,445 for Mr Ali and £45,000 for Mr Bradley. However, the issues determined arose in another 40 potential claims that Webb had against E.Surv and Webb had more than 200 claims against other valuers which also may discuss similar points. [439]

For negligent valuation cases, the approach is to focus on the result, or the negligent valuation itself, rather than the methodology. If the valuation was outside the reasonable margin, the valuer was automatically negligent and this spotlights the way in which the original valuation was performed.[440] For residential valuations, the parties agreed that one bracket, calculated by reference to the correct valuation figure, would be appropriate to determine the permissible margin of error.[441]

The Ali Valuation

For The Ali Valuation, Mr Tomalin, an employee of E.Surv, was an experienced valuer and knew that the asking price was £227,995. The true value was held to be £204,658, therefore there was an over-valuation of 11.4%.[442] The mortgage valuation report was dated 28th November 2012 and the notes of his earlier site visit dated 22nd November 2011. He went to inspect the property, but was given a floor plan and told he could not access the flat because construction would not be finished for another 2 weeks. The valuation was therefore based on Mr Tomalin's impression of the new building generally, the floor plan of the property which he had been provided, and what he was told by the sales team. According to his notes, his visit lasted just 10 minutes. Mr Tomalin had no figure of his own for the internal area. His notes emphasised the "enormous balcony" area. Mr Tomalin had a list of comparables which he had printed off from the Quest database, but this data was not entirely reliable for comparison purposes. These properties had lower £/square metre rates than Mr Ali's property, but Mr Tomalin justified the asking price on the basis of the "massive balcony" and valued the property at the asking price.[443]

Mr Tomalin breached the standard to be expected of a reasonable valuer. This is because he produced his valuation without inspecting the property, even though the form that he signed expressly certified to GMAC that the property "has been inspected by me". The mortgage valuation form was therefore fundamentally misleading because it expressly represented that an

[439] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 256.
[440] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 260.
[441] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 261.
[442] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 267.
[443] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 262.

inspection had been performed when it had not. Secondly, the Judge was not persuaded that he asked the sales team about incentives on the property because of short timeframe of the visit and the careless nature of the variation. Thirdly, the use of the Quest database figures were not reliable and this had an important impact on the correct valuation figure for Mr Ali's property. The final way Mr Tomalin did not meet the appropriate standard is because he used the asking price, then worked backwards to justify that figure. The Quest database figures showed that the purchase price was not objectively justified. He recognised that the balcony was of a large size, so should have determined the value of the flat and the balcony separately.[444]

In *K/S Lincoln v CB Richard Ellis Hotels Ltd* the potential permissible margins of error could be 5% for a standard residential property, 10% for a one-off property, or 15% if there are exceptional features of the property in question and this figure may be even higher in appropriate circumstances.[445] The Judge determined that the correct permissible margin of error in relation to the Ali property was 5%. This is because there were many similar properties, a two bedroom city centre flat in the middle of Birmingham, for sale all over the city centre. It was extremely far off from being a one-off property. There was no shortage of meaningful comparables. Therefore, the final figure was held to be £204,658, there was an over-valuation of 11.4% which is above the permissible margin and Mr Tomalin was negligent. But for the negligence, the loan would not have been made to Mr Ali.[446]

When Mr Ali failed to make the mortgage repayments, GMAC sold the property for £135,000, the highest possible price obtainable, and suffered a shortfall of £103,311.83 and incurred £12,000 in repossession costs.[447]

E.Surv made allegations of contributory negligence of GMAC in failing to look after their own interests and that their negligence in so doing caused the loss of which GMAC complain. GMAC's business model relied on three principles: what mattered most was the speed with which the mortgage application was dealt with; that self-certified mortgages were an entirely appropriate product even for those who were 'credit-impaired'; and that property prices would carry on rising.[448]

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[444] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 263 and 264.

[445] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 261; *K/S Lincoln v CB Richard Ellis Hotels Ltd* [2010] EWHC 1156 (TCC), [2010] PNLR 31.

[446] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 267.

[447] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 268.

[448] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 271.

Mr Ali's application form was dated 1 December 2006 and sought a self-certified mortgage of £193,500. £34,495, being the balance of the purchase price of £227,995, was being paid out of savings. Mr Ali had a low credit rating, which was what led him to seek a self-certified mortgage.[449] However, the allegations of contributory negligence did not succeed because lending large sums on a self-certified basis through intermediaries, and placing complete faith on computerised tick-box forms, was the norm for lending in 2004-2007. The decision to lend to him was not irrational or illogical or negligent and Mr Ali's financial position was not such that further investigations were required.[450]

The Bradley Valuation

The mortgage valuation report was completed by Mr Honeysett, an experienced employee of E.Surv, on 10 July 2007. The Bradley property was a detached four bedroom house with an integral garage. It had a railway line running behind it. Mr Honeysett was told that Mr Bradley wanted a loan of £280,000 and had stated that his property was worth £295,000.[451]

Mr Honeysett spent 15 minutes at the property and carried out a measurement of its external area. He had the Quest data in table form, but it is unclear what regard Mr Honeysett paid to it and the estimated prices were unreliable. Mr Honeysett used information from Your Move, paying particular regard to two comparable properties. Mr Honeysett indicated a range for the value of the property to be within £270,000-£300,000 and concluded that the true valuation should be £295,000, the same value stated by Mr Bradley. The true value was found to be £260,000, therefore there was an over-valuation of 21%.[452]

Mr Honeysett's performance of the valuation fell below the standard to be expected of a reasonable valuer. This is because he started at the end and then sought to justify the figure which he had been given instead of valuing the property independently. He worked out a range and instead of valuing at the figure in the middle of that range, he tried to justify a figure at the top end of it, he added a 5% margin to the middle figure. Thirdly, he failed to take into account obvious adverse factors that affected the property, such as the presence of the railway line behind the property, shown by ticking the box on the site notes to say that there was no adverse

[449] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 273.

[450] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 276.

[451] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 277; Clarke Wilmott "Professional negligence claims: Comfort for lenders?" (7 February 2013) <www.clarkewillmott.com>. https://www.clarkewillmott.com/news/professional-negligence-claims-comfort-for-lenders/

[452] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 278; Clarke Wilmott "Professional negligence claims: Comfort for lenders?" (7 February 2013) <www.clarkewillmott.com>. https://www.clarkewillmott.com/news/professional-negligence-claims-comfort-for-lenders/

locational feature. The proximity of the council estate was also not taken into account. However, although Mr Honeysett's methodology is negligent, the test is whether the valuation figure is negligent.[453]

The properties used as comparables were better than the Bradley property for a number of reasons such as more rooms, location and a private road. Even without deductions for these factors, the range between the two comparables should have been £270,000-£285,000. The Judge determined that the permissible margin of error for the Bradley property was 5% because there was a wealth of comparable properties and Mr Honeysett was endeavouring for this margin, as well as the expert. The difference between the valuation and the true value was more than 10%. But for that negligence, the loan would not have been made to Mr Bradley.[454]

Mr Bradley needed £295,000 for the remortgage on his home, his application was essentially treated as a self-certified mortgage. He failed to answer credit history questions on his application form. He was also subject to an outstanding County Court Judgment and had two credit card defaults which totalled around £18,000. It appears that these defaults were the reason for the remortgage.[455]

Three particular allegations of negligence were made. The loan to value applied in Mr Bradley's case was 95%, which is high compared to the marketplace. A reasonably centralised lender would not have allowed the application for a remortgage at a 95% loan to value ratio. The application was not stated to be self-certified, but it was how it was treated. Mr Bradley stated an income figure of £75,000, but there was no third party support for this claim and although the accountant was contacted, he was not asked to verify Mr Bradley's income. The failure to ask the accountant questions to verify Mr Bradley's income was negligent, those questions would have indicated that Mr Bradley's financial position was particularly problematic and the loan would probably not have been made at all. Mr Bradley was plainly in financial difficulty and because the loan was to consolidate Mr Bradley's debts and because a loan to value ratio of 95% is beyond the normal rate for the marketplace, GMAC were obliged to consider the loan very carefully. They failed to look after their own interests and made a loan of 2280,000, which a reasonably competent centralised lender would not have made.[456]

[453] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 278 and 279.

[454] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 280.

[455] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 284.

[456] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 285 and 286.

The contributory negligence was 50% because the Judge concluded that GMAC and E.Surv were equally at fault. E.Surv did not value the property properly and GMAC should never have lent the money.[457]

10. *Melbourne Mortgages Ltd v Berry* [2013]

One of the grounds alleged by the defendant debtor in this case was based on irresponsible lending by the creditor.

This case was an application to set aside an order dated 22 October 2008 for possession of the defendant's home. The possession order was suspended on 24 February 2009 subject to the defendant making payments, but as they failed to do so, the creditor was able to enforce the order on 9 March 2011. The defendant counterclaimed under ss 140A and 140B of the Consumer Credit Act 1974 on the basis that an unfair relationship existed between the parties.[458]

A loan of £102,500 with a flat annual interest rate of 9.9% and an APR of 15.4% was secured over the defendant's home. Fees of £2,500 were added onto this principal, which included a broker's fee and an administration fee. The loan was initially obtained for the defendant to discharge a first mortgage that the defendant owed to another mortgagee and to provide funds for the defendant to enter into an entrepreneurial project, which failed. The loan was assigned by Prestige to the plaintiff, Melbourne Mortgages Ltd, for the 20 year remainder of the mortgage term. As at 22 May 2012, the arrears of instalments were £21,935 and the remainder to be paid under the mortgage is £137,969.[459]

The arguments submitted by the defendant are:

a) Charge deed was signed by the solicitors on behalf of Prestige on 12 December 2006, but the deed was not executed for lack of delivery.
b) The plaintiff paid the defendant's broker a secret commission of £3,075 in addition to the disclosed commission of £2,000. It was argued that this gives rise to an unfair credit relationship under ss 140A and 140B of the Consumer Credit Act 1974.
c) There is discretion to withhold or postpone the delivery of possession of registered land to the mortgagee.[460]

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[457] *Webb Resolutions Ltd v E.Surv Ltd* [2012] EWHC 3653 (TCC), [2013] PNLR 15 at 286.

[458] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [1].

[459] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [2] and [3].

[460] Land Registration Act (Northern Ireland) 1970 Sch 7 Pt I paras 5(2) and (3).

d) That the creditor has not discharged the reverse burden of proof under s 140B of the Consumer Credit Act 1974, which requires the creditor to prove that an unfair relationship does not exist once it is alleged.
e) "*The Plaintiff engaged in asset-based irresponsible lending in contravention of proper practice and guidelines promulgated by the Office of Fair Trading and (in the context of mortgage transactions regulated under the Financial Services and Markets Act 2000, which does not apply to the charge) the Financial Services Authority. There was no proper assessment of the borrower's ability to repay the loan and in effect Prestige relied on the Defendant's statement of his income only along with the value of the dwelling. Prestige made no searches or enquiries to ascertain the affordability of the loan, did not discuss affordability with him or seek corroboration of his Statement of Income or inquire as to the Defendant's other debts and outgoings generally.*"[461]

The first argument failed because the acceptance by Prestige's solicitors signing the deed was enough to constitute delivery.[462]

The defendant misrepresented his income as being £40,000 per annum or £3,333 per month, when in reality, his income was less than half of this.[463] The plaintiff also misrepresented that the broker's fee was £2,000, when the fee was £5,075.[464] Ellison M stated that would have to decide the case on the basis that "each of the parties to the mortgage was induced by the dishonesty of the other to enter into the transaction and make substantial payments as a result" and that here, it would not be appropriate to set aside the transaction under s 140B of the Consumer Credit Act 1974 for a dishonest borrower.[465]

Prestige and their broker breached the obligation not to deceive the borrower, to fully disclose the true amount of the commission and not to charge flat interest on the mortgage.[466] The Office of Fair Trading guidelines require transparency in all dealings, including the brokerage fee or commission payable, and responsible lending subject to a proper assessment of the borrower's ability to repay and taking full account of all relevant circumstances. The lender should not use an annual flat interest rate because this may mislead borrowers. There will be irresponsible

[461] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [5].
[462] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [6].
[463] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [7].
[464] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [8].
[465] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [10] and [11].
[466] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [15].

ending if a lender fails to check the borrower's ability to repay a loan secured on the borrower's property.[467]

The possession order was set aside under s 140B and a declaration that an unfair credit relationship exists was made under s 140A of the Consumer Credit Act 1974. The relief granted under s 140B of the Consumer Credit Act 1974 was, primarily, a revision of the terms of the mortgage so that the interest rate on the principal is 8% per annum simple interest. The mortgage required that the defendant will have to repay the outstanding principal at the new interest rate by monthly instalments over 20 years from 12 December 2006. The interest penalties for early redemption and the bar on making partial payments of capital were removed from the contract. The plaintiff was also unable to charge flat or compound interest or default charges.[468]

Regulation on interest rates for high cost loans

The UK has had both a 100% total repayment cap and an interest rate cap imposed on high cost lending since 2015. The interest rate cap limits interest on high cost short term loans to 0.8% a day and this resulted in a significant increase of declined borrower applications. Also, as part of this package of reform, another element of the UK cap includes limited default charges to 15 pounds and forbidding a default interest rate.[469]

These three parts of the cap have been considered by the FCA to be necessary and each play a different role in protecting consumers. The interest rate cap of 0.8% per day protects all borrows from excessive charges. The cap on default fees protects borrowers who make late repayments from incurring excessive charges on default. The total cap limits escalating interest, fees and charges and getting into debt spirals.

For more information on the interest rate regime in the UK, see the paper *"Interest rate caps, what do we know about their use and impact in other jurisdictions and how might they contribute to a fairer consumer credit regime in New Zealand"* prepared as part of the research funded by the Borrin Foundation on consumer credit reform.

[467] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [13] and [14].

[468] *Melbourne Mortgages Ltd v Berry* [2013] NIMaster 3 at [18].

[469] Borrin Foundation *Interest rate caps, what do we know about their use and impact in other jurisdictions and how might they contribute to a fairer consumer credit regime in New Zealand* at 10.

Dispute Resolution in the UK

The Financial Ombudsman Service (FOS) was set up by Parliament in 2000 by the Financial Services and Markets Act 2000[470] and can consider complaints if the complainant is eligible (a consumer is an eligible complainant),[471] the respondent was an authorised person at the time of the act of omission to which the complaint relates and the act or omission to which the complaint relates occurred at a time when compulsory jurisdiction rules were in force in relation to the activity in question. The FOS can also consider debt collection that arose from exempt[472] consumer credit and consumer hire agreements, even if the contract was entered into before 1 April 2014. The FOS can also consider complaints about debt collection arising from certain peer to peer agreement, but as this only became a regulated activity on 1 April 2014, only complaints about events after this date can be considered. Previously, the FOS could only consider complaints about debt collectors where the basis for the complaint was about an attempt to collect a debt that originated from a regulated consumer credit or consumer hire contract. The FOS cannot consider complaints about the collection of debts such as:

- Council tax,
- Utility bills, or
- Rent arrears.[473]

As of March 2018, firms providing consumer credit that have not been complying with regulations have given over £900 million in redress back to customers.[474]

[470] Financial Services and Markets Act 2000, pt XVI and sch 17; and Financial Ombudsman Service "Official documents underpinning our statutory functions and powers" <www.financial-ombudsman.org. https://www.financial-ombudsman.org.uk/about/official-documents.html

[471] See Financial Conduct Authority *Dispute Resolution: Complaints* (March 2019) at [2.7.3] for other eligible complainants.

[472] An "exempt" agreement is defined in the Consumer Credit Act 1974, s 16 where the Act does not regulate a consumer credit agreement where the creditor is (s 16(1)) a local authority or building society, an insurance company, a friendly society, an organisation of employers or organisation of workers, a charity, a land improvement company, or a body corporate named or specifically referred to in any public general Act. Further, under the Consumer Credit Act 1974, s 16(2), the agreement must be for financing the purchase of land, or provision of dwellings on any land, an agreement secured by any land mortgage.

[473] Financial Ombudsman Service "Debt Collecting" <www.financial-ombudsman.org.uk>. https://www.financial-ombudsman.org.uk/publications/technical_notes/debtcollecting-note.html

[474] Financial Conduct Authority "Consumer Credit: 4 years of FCA regulation" (press release, 27 March 2018). https://www.fca.org.uk/news/press-releases/agenda-priorities-consumer-credit

The FOS has a compulsory jurisdiction and a voluntary jurisdiction. The scope of these two jurisdictions depend on:

1) "The type of activity to which the complaint relates;
2) The place where the activity to which the complaint relates was carried on;
3) Whether the complainant is eligible
4) Whether the compliant was referred to the FOS in time."[475]

Complaints can only be considered under the compulsory jurisdiction if it relates to "activities of a firm (including its appointed representatives), of a payment service provider (including agents of a payment institution), of an electronic money issuer (including agents of an electronic money institution), of a CBTL (consumer buy to let) firm, of a designated credit reference agency or of a designed finance platform carried on from an establishment in the UK".[476] The FOS' voluntary jurisdiction covers only complaints about the activities of a voluntary jurisdiction participant carried on from establishment in the UK and elsewhere in the European Economic Area if the activity is directed wholly or partly in the UK, contracts governing the activity are made under the law of England, Wales, Scotland or Northern Ireland, and the participant has notified appropriate regulators in its Home State of its intention to participate in the voluntary jurisdiction.[477]

[475] Financial Conduct Authority *Dispute resolution: Complaints* (March 2019) at [2.2.1].

[476] Financial Conduct Authority *Dispute resolution: Complaints* (March 2019) at [2.6.1].

[477] Financial Conduct Authority *Dispute resolution: Complaints* (March 2019) at [2.6.4].

11. OTHER ISSUES

Section 136 CCCFA

Consequences of non-compliance with statutory requirements

It is notable that the MBIE proposals at no stage refer to s136 of the CCCFA, a section which is of very considerable importance at present and will become much more important if any form of interest rate cap or service fee cap is implemented. It is highly desirable that the effects of s 136 be carefully analysed and be taken into account in shaping changes to the legislation.

Section 136 provides:

136 Application of law relating to illegal contracts

The fact that a credit contract, a consumer lease, or a buy-back transaction has been entered into in breach of this Act, or that an act that breaches this Act has been committed in the course of the performance of any contract, lease, or transaction, does not—

(a) make that contract, lease, or transaction illegal; or

(b) make that contract, lease, or transaction or any provision of that contract, lease, or transaction unenforceable or of no effect, except as expressly provided in this Act.

There are no provisions in CCCFA which expressly provide for matters in breach of the Act to be illegal or unenforceable. Three sections stipulate that certain provisions in particular kinds of transactions are of no effect: s 76 (2) – provisions in buy-back schemes prohibiting lodging of caveats of no effect; s 83M(2) in relation to disabling devices for consumer goods and s 83ZO in relation to provisions purportedly granting a security interest over goods specified in s 83ZN.

As yet, no consideration appears to have been given to the question of whether credit contracts which breach a statutory interest rate cap or service fee cap should be illegal or otherwise unenforceable.

The core issue with this aspect of the CCCFA is that non-compliance with the Act does not render the loan contract unlawful and unenforceable. As such this does not parallel the general law of contract, although there are certain other kinds of contracts where breach of a statute is stated not to make a contract unlawful.

The general position in contract law (statutory exceptions aside) is that breach of a statute either in the formation of a contract or in its performance will make the contract illegal, and therefore ineffective to create rights or obligations, where treating the conduct as lawful would frustrate

the express words or the purpose of the statute breached.[478] Where a contract is illegal, the court may grant relief by way of validation, variation or compensation in appropriate cases.[479]
Section 136 CCCFA appears to have been intended to avoid any possibility of the courts or the Disputes Tribunal being able to vary and validate loan contracts, particularly by significantly changing the interest rate payable under the contract or awarding compensation to a borrower who had already paid a significant sum by way of interest on a relatively small sum borrowed. It may be doubted that there is real substance to this concern.

The issue of illegality must be addressed if Parliament were to adopt suggestions for a cap on the interest rate chargeable on consumer loans etc. What is to be the effect of a lender is stipulation for a higher rate? Under the current law, the borrower would have to pay the interest rate stipulated - even if it exceeds the statutory maximum - and then seek to have the contract reopened.

Two issues immediately present themselves. The first is that despite the best efforts of government and non-government agencies alike, many borrowers will remain in ignorance of the effect of an interest rate cap and will pay - or endeavour to pay- the illegal rate of interest where such a rate has been stipulated without seeking to challenge the contractual term. (Given the lack of compliance with the current law – see for example the MBIE desk study research - MTD it seems most unlikely that there will not be lenders who ignore or attempt to circumvent any statutory limitation).

Secondly where a borrower seeks to challenge the interest rate stipulated, the contract will remain in force up to the time that a Court or tribunal declares otherwise.

There is however provision under the act for a court or tribunal to "re-open" a credit contract where the circumstances.

S 136 appears to be unfair on borrowers particularly in the context of loans which may have a relatively limited repayment period. Indeed the fact that the loan remains enforceable until the court orders otherwise may act as an incentive to lenders to adopt illegal measures in the hope that no enforcement action is forthcoming.

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[478] Contract and Commercial Law Act 2017, s72. For a full discussion of illegality in contract law in New Zealand see Finn, Todd and Barber "*Burrows, Finn and Todd on The Law of Contract in New Zealand*" (6th ed 2018, Wellington, LexisNexis) ch 13.

[479] Contract and Commercial Law Act 2017, ss 75 and 76.

12. Appendix 1

Academic paper on the use of infringement offences as a regulatory tool

Enforcing CCCFA rules – is there too much emphasis on the infringement fee system?

Professor Jeremy Finn

5/3/2019

1. Of infringement fee schemes

The CCCFA currently provides for two different forms of proceedings against those breaching the Act. One is for a conventional prosecution; the other an infringement fee system. An "overlap" arises because:

(a) for many offences the prosecutor (usually the Commerce Commission) may either proceed by filing a charging document under s14 Criminal Procedure Act 2011 or it may serve an infringement notice requiring payment of a fixed infringement fee; and

(b) A person served with an infringement notice who does not accept liability may insist on the matter going before a judge to determine whether the offence was committed and/or the appropriate penalty.

A key feature of any infringement notice/infringement fee proceeding is that payment of the infringement fee stipulated brings the matter to a close. No conviction is recorded. If the defendant does choose to contest the infringement notice so that the matter does come before a court, the judge cannot impose a conviction,[480] but may however impose a fine, order payment of court costs and/or make ancillary orders where the statute so allows.[481]

An infringement notice and fee regime where liability is not contested does not require the enforcement agency to prove the facts of the offending if liability is not disputed. If the facts are not contested, liability to pay the infringement fee follows automatically. It is important to note that an infringement fee system, although administratively convenient and both cheaper and speedier than a prosecution for offending has several features which detract from its appeal.

[480] Criminal Procedure Act 2011, s 375

[481] For discussion of the use of such orders in CCCFA cases see [CCCFA cases in the courts 2015-2018 material].

In particular an infringement fee system cannot and does not take into account any of the following matters:

- The ability of the offender to pay the infringement fee.[482] This weakness has been pointed out by commentators both in New Zealand and overseas.[483] In the CCCFA context, an infringement fee will be the same whether the offender is a wealthy or a poor trader.
- The financial consequences for the offender of the breach - so the infringement fee is the same whether the lender benefitted from the breach or not, and whether any benefit was large or small
- The circumstances of the offending (for example whether the person responsible for the relevant conduct was generally careless or made an isolated mistake).
- The prior behaviour or record of the offender.

All those matters can be taken into account if the alleged offender disputes the infringement and the matter goes to trial. It is settled law that a judge who imposing a sentence for a disputed infringement offence should impose the appropriate punishment for the offender before them. This will be a fine, but the quantum can be higher or lower than the infringement fee.[484]

2. *Testing the design of infringement fee regimes*

The Ministry of Justice has published a *Policy Framework for New Infringement Schemes* which states relevant principles and sets out guidelines for new schemes.[485] While these guidelines are designed to create consistency of principle across future infringement schemes, they also provide useful criteria for testing the design of existing infringement schemes, such as those found in the CCCFA. Several elements of the guidelines are relevant to any such evaluation.

Firstly, we may look at the Ministry's definition of such schemes, which makes a number of points about why such schemes may be adopted. The Policy Framework provides:[486]

What is an infringement scheme?

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[482] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, at [38].

[483] David Wilson "*Instant Fines: Instant Justice? The Use of Infringement Offence Notices in New Zealand"* Social Policy Journal of New Zealand, Issue 17, December 2001, pp 72 -81 at 76; Gaye Lansdell, Anna Eriksson, Bernadette Saunders and Meredith Brown, "Infringement Systems in Australia: A precarious blurring of civil and criminal sanctions?" Alt LJ Vol 37:1 2012, pp 41-45, at 44.

[484] *Nelson City Council v Howard* [2004] NZAR 689, [37]-[40], followed in *Westland Air Charter Ltd v Director of Civil Aviation* [2015] NZHC 2119, at [10]. See also *Young v Police* [2007] 2 NZLR 382 and *Moses v Auckland City Council* HC Auckland CRI-2010-404-306, 21 December 2010.

[485] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes.

[486] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, at [4]-[7].

4. The purpose of an infringement scheme is to:
• Achieve compliance with the law and to reduce the harm caused by minor offending;
• Hold people accountable for their actions and to promote a sense of responsibility; and
• Educate people about unacceptable conduct and its inherent social harm.

5. An infringement scheme provides an administratively efficient method of encouraging compliance with the law by imposing a set financial penalty following relatively minor breaches of the law.

6. An infringement offence notice is a proportionate response to offending, which avoids the formality of court proceedings and does not impose a full criminal penalty.

7. The system involves both benefits and trade-offs for the prosecuting agency, the defendant and the justice system.

a. The prosecuting agency does not have the cost of bringing court proceedings or of proving the elements of the offence. However, by using an infringement notice, it reduces the penalty level imposed and, through being unable to obtain a criminal conviction, lowers the deterrent effect and other impacts such as moral condemnation.

The "proportionate response" mentioned in [6] above is commented on later:

24. Infringement offence schemes are suitable for addressing comparatively minor breaches of the law, which warrant more than a warning, but less that the full sanctions of the criminal law.

However the force of the statement in [24] is then undercut somewhat by the "Guideline Appropriate use" summary which states:

Guideline – Appropriate use[487]
An infringement offence scheme should:

• Address misconduct that is generally regarded as being of comparatively minor concern to the general public, but may address more serious matters provided the following considerations also apply.
• Involve actions or omissions that involve straightforward issues of fact.
• Only apply to strict or absolute liability offences.
• Be an appropriate mechanism or part of an appropriate mechanism to encourage compliance with the law.

A later section of the Guidelines addresses penalties, and states that

- As a general rule, every offence which is subject to an infringement notice should not normally exceed a fee of $1,000, unless in the particular circumstances of the case a high level of deterrence is required. The fee should generally be considerably less than the statutory maximum available to the court following a successful prosecution: and that

[487] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, "Guidelines- Appropriate use"

- In setting infringement fees, consideration must be given to the level of harm involved in the offending, the affordability and appropriateness of the penalty for the target group, and whether the proposed fee is commensurate with the infringement fees for other comparable infringement offences.[488]

An implied upper limit to the use of infringement fees is stated later where it is said that a separate offence provision should be established in the primary legislation where an offence may warrant a more serious penalty, or different treatment.[489] However, again, the following guidelines may dilute that message, as it is stated that:

> 32. Higher maximum infringement fees are often necessary to deter offending where a significant economic benefit can result for the offender. Examples of offending with significant economic benefit include the avoidance or evasion of Road User Charges, the overloading of heavy vehicles and the breaching of marine protection zones.[490]

It is obvious from the case law that many lenders have benefitted significantly from avoidance or breach of CCCFA requirements.[491]

3. *Critique of possible issues with use of an infringement fee system for CCCFA breaches*

(a) Are fixed fees fair and in accord with sentencing principles?

Infringement notices can be seen as a classic form of "just deserts" sentencing, under which Parliament, or its delegate, has determined that the proper level of "punishment" to impose on a law-breaker is a fine of $X, a punishment in theory determined solely on the nature of the infringing conduct in question and regardless of the characteristics of the offender or the consequences of the breach. The imposition of a fixed monetary penalty so that the means of the offender are not considered may be seen as inconsistent with normal sentencing principles.[492]

Further, section 8 of the Sentencing Act 2002 provides, in its list of sentencing principles to which a court has to have regard, a direction that the judge must impose the maximum penalty available to the offence if the offending is within the most serious of cases for that offence, unless there is some circumstance relating to the offender which would mean a lower sentence is

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[488] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, "Guideline – Penalties".
[489] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, at [30].
[490] www.justice.govt.nz/publications/global-publications/i/infringement-guidelines/guidelinesfor-new-infringement-schemes, at [32].
[491] Cross-reference to chapter on CCCFA in the courts 2015-2018 needed.
[492] Law Commission *Delivering Justice For All: A Vision for New Zealand Courts and Tribunals* (NZLC R85, 2004) at [2.2.36].

appropriate, and – in parallel, sentence near the maximum should be used where the offending is close to the most serious cases of that kind of offending.[493]

Clearly a "one size fits all" infringement fee is totally inconsistent with that principle. There must be a significant question of principle about using infringement fees for all but minor offences (a category which would exclude most CCCFA breaches) where there is this disjunction between the infringement fee response and the court's sentencing process.

(b) The lack of a conviction and the lack of publicity

As noted earlier, an infringement fee system does not result in a conviction. The Ministry of Justice, in a study published in 2000, stated that "One view is that the application of an infringement fee to any particular offence, thereby removing its criminal status, may lessen the seriousness with which that offence is publicly regarded."[494] The Ministry went on to say that because defendants proceeded against by way of infringement notices do not receive a conviction, the "social opprobrium associated with the offence is zero."[495] It has been argued that the removal of, or weakening of, the deterrent effect of public punishment may actually reduce compliance and increase offending.[496]

What may be as important – or more important – is that infringement fee proceedings are likely to take place with very limited publicity. There may be a press release from the enforcement agency, but this is not likely to attract significant media attention in the way the report of a trial and conviction would do. (The latter may also be more effective at prompting other consumers who have been the subject of breaches to make complaint to the enforcement agency).

It should also be noted that there is a substantial body of literature, particularly in European jurisprudence, which argues that the criminal law has a "moral-educative function" of identifying and reinforcing basic social norms and ideas of what is right and wrong. While most individuals are socialised about right and wrong in the family, the school, church and community, the norms require reinforcement and elaboration. The law, and the courts, can do this by imposing punishment which indicates the criminal conduct was wrong. The largely private nature of infringement fee regimes is obviously inconsistent with such a moral-educative function.

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[493] Sentencing Act 2002, s 8(c) and (d).

[494] Ministry of Justice *Review of Monetary Penalties in New Zealand* (June 2000) <www.justice.govt.nz/publications/global-publications/r/review-of-monetary-penalties-innew-zealand/issues-for-fines-and-infringement-fees-1>

[495] Ministry of Justice *Review of Monetary Penalties in New Zealand* (June 2000) <www.justice.govt.nz/publications/global-publications/r/review-of-monetary-penalties-innew-zealand/issues-for-fines-and-infringement-fees-1>.

[496] David Wilson "Instant Fines: Instant Justice? The Use of Infringement Offence Notices in New Zealand" (2001) 17 Social Policy Journal of New Zealand 72 at 79

(c) Downgrading the perceived seriousness of CCCFA offending

There is one important aspect of the debate about infringement offences which has been largely missing from debate in New Zealand. British philosopher and criminologist Antony Duff argues that once Parliament, acting for society generally, articulates certain norms as right and non-compliance with them as wrong, society is committed to punishing transgressors because doing otherwise implicitly undermines the declaration the norm is right and transgression is wrong.[497] In imposing punishment, the courts communicate both to the offender and to the wider community a message as to those norms. However, doing so effectively requires what Duff calls a "substantive fit" between the offending and the sentence to ensure the right messages are sent to the offender, the victim and the community.[498] Duff argues that the most serious sanction, imprisonment should be restricted to the most serious kinds of crime because it is the most intrusive and sends the strongest message. Clearly New Zealand does not always do this in its legislation, but the Sentencing Act 2002 does require judges to select the least restrictive sentence which is appropriate.[499]

What does need to be taken into account is whether the reverse of Duff's argument is true. If an offence cannot be punished by imprisonment, is society sending a message that this is a relatively trivial offence, and a failure to comply with the norm that it seeks to promote is not to be regarded as really culpable behaviour? Danielle Duffield has criticised changes to the animal welfare legislation which brought in more infringement offences precisely on the basis that they positioned offences alongside mere regulatory breaches, which was significant because "the characterising features of this class of offences are a low degree of seriousness and an absence of significant moral blameworthiness."[500]

In the context of regulatory offences, there is the risk that breach of the regulatory scheme is seen as not in itself wrongful behaviour, but merely as contrary to a bureaucratic rule. That mindset can easily influence those in the field of activity being regulated that infringement fees or fines are really only a cost of doing business – a kind of licence fee to be paid by those whose breaches are detected. Traders and lenders who breach the CCCFA may cause great hardship to their victims. Anything which lowers the perceived seriousness of such offending – whether in the eyes of the public or in the eyes of offenders and potential offenders – is to be deprecated and avoided.

[497] Antony Duff, *Punishment, Communication and Community* (OUP 2001), at pp 28-29
[498] Antony Duff. *Punishment, Communication and Community* (OUP 2001), at p 142ff.
[499] Sentencing Act 2002, s 8(g).
[500] Danielle Duffield, 'The enforcement of animal welfare offences and the viability of an infringement regime as a strategy for reform' (2013) 25(3) *New Zealand Universities Law Review* 897- 937, at 925-926.