NGĀ TANGATA MICROFINANCE TRUST

MICROFINANCE FOR THE PEOPLE TRUST

To: Commerce Commission, at creditfeesubmissions@comcom.govt.nz.

From: Nga Tangata Microfinance Trust
www.ntm.org.nz

25 October 2016

Submission: Consumer Credit Fees Guidelines

Nga Tangata Microfinance Trust (NTM)[1] thanks the Commerce Commission for the opportunity to submit on the Consumer Credit Fees Guidelines which describe the Commission's view on how lenders should approach setting their fees in order to comply with the Credit Contracts and Consumer Finance Act 2003 (CCCFA) and amendments which came into force in June 2015. The Guidelines set out the general principles that lenders should take into account and give examples of how these principles might apply in practice. They also give guidance on whether or not particular types of costs can be included in fees.

Unmanageable debt is a poverty trap. Reasonable terms, and reasonable charges, return financial control to the borrower. Ethical lending, including limits on the costs of borrowing and other consumer protections in the Consumer Credit Guidelines could free whole communities from unmanageable debt.

NTM welcomed the possibilities in the amendments to the CCCFA Act to ensure social justice and end usury in the low income communities of Aotearoa New Zealand. Features often found in such communities include low average hourly wage; higher than average number of occupants per household; shocking child poverty statistics; and internationally high rates of third world diseases among children. Other likely features are low rates of home ownership, high levels of mobility, and unmanageable levels of high-interest debt.

NTM works every day with people adversely affected by non-bank fringe lenders. A robust, ethical and socially responsible financial system lays the foundation for sound and sustainable economic growth. It also exerts an important influence on wider social outcomes, such as social and financial inclusion, access to affordable housing, employment,

[1] **Nga Tangata Microfinance Trust** was established in 2010 for the purpose of alleviating poverty by building a more just and equitable society with economic and social inclusion for all New Zealanders. To achieve this vision, we advocate for and assist in the provision of safe and fair affordable finance options that strengthen financial independence by providing small no interest, no fees loans to qualifying low income people. The Trustees are appointed by the participating organisations: Child Poverty Action Group (CPAG) Aotearoa Inc.; New Zealand Federation of Family Budgeting Services (NZFFBS); and New Zealand Council of Christian Social Services (NZCCSS). The Trustees work in close collaboration with the loan capital funder, Kiwibank, and acknowledge the ongoing contribution of Australia's Good Shepherd Microfinance, the J.R.McKenzie Trust, Presbyterian Support Northern (PSN), and the Ministry of Social Development. The operational arm of Nga Tangata Microfinance Trust in New Zealand is Nga Tangata Microfinance Ltd (NTM). The Directors of NTM represent the participating organisations: CPAG, Methodist Mission's Lifewise (Auckland Synod and Sinoti Samoa), Whanau o Tumanako (Maori Women's Welfare League) Manurewa, and Mangere East Family Service Centre (MEFSC). The face-to-face work with NTM clients is carried out by participating NZFFBS Budgeting Advisors.

and the ability and capability of people to thrive. Conversely, an unethical financial system fosters financial exclusion of individuals and communities.

Our current lack of consumer protection against predatory lending undermines the economy, creates financial instability and avoidable hardship, and contributes to the devastation wrought by unmanageable debt – the real 'poverty trap'. It is in everyone's interests that New Zealand has a financial system that is sound, ethical and socially responsible.

In the current environment, 10% interest per week is common and legal; a missed payment on a $500 loan can incur a $100 administrative charge; as security on a $500 loan the lender may have a lien over all the borrower's possessions: car, fridge, TV, and even the children's beds. Such practices are unethical and exploitative. The Consumer Credit Fees Guidelines provides another opportunity to make such practices unlawful.

To achieve an environment of safe, fair lending, NTM argues that critical requirements include, in addition to a limit on the fees legally chargeable: an interest rate cap thus limiting the cost of credit; adequate disclosure; an adequate cooling-off period; and reconsidered hardship provisions.

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Submissions:

Discussion 1: The amendments to the CCCFA Act in 2015 introduced the Lender Responsibility Principles which reinforce and require that lenders comply with all of their obligations to borrowers, including to ensure that fees are disclosed in plain language in a clear, concise and intelligible manner **(5)**. However, as the recent ANZ financial literacy survey[2] showed, 68% of people questioned did not understand compound interest.

Submission 1: Include the 'total cost of credit' in the $ amount in the loan contract.

Discussion 2: We are deeply concerned that it continues to be the law that, as the 'General fees principles' states: 'Fees are restricted, but interest is not'. The draft Guidelines state at **(20)**: *The concept of reasonableness is central to the fees provisions. The assessment of reasonableness is an objective one.* For example, in New Zealand, the non-bank business 'Cash in a flash' can legally advertise interest charges 'from 1.2% per day', so from438% annually.

Other countries cap charges on consumer credit: Bangladesh is 27%; Australia is 48% maximum annually including fees and charges; USA is 18% to 25% plus a maximum on the administration fee; Japan has a 20% maximum annual charge; and South Africa has a 60% annual maximum charge. Note also that 'usury' is illegal in 21 European Union states, although it remains legal in New Zealand.

[2] ANZ CFLRI (2013) 2013 *Financial Knowledge and Behaviour Survey*
Key Point Summary, p. 6, at http://www.anz.co.nz/resources/2/8/28529b36-f4ff-4e5d-83dc-029127002107/Survey-Summary-2013.pdf?MOD=AJPERES

Submission 2: Include the 'total cost of credit' in the assessment of 'reasonableness'.

Discussion 3: The Draft Guidelines state: **(56)** Some lenders do not endeavour to match their relevant costs to their fees, but rather impose a percentage-based fee, for example an establishment fee of 10% of the principal being borrowed. **(57)** Without the lender conducting a cost-accounting exercise, it is improbable that a fee set by this method will be reasonable. It is possible that the fee might by chance equate to the lender's reasonable costs – but is unlikely. If the lender's loan amounts and terms often vary, a percentage-based fee will be especially unlikely to accurately recover only transaction-specific costs.

Some companies employ a system of inflated costs, charge no interest on the credit they provide, and then charge a very high percentage-based exit fee from the contract (if goods not yet received eg catalogue/online sales).

Submission 3: When concluding a layby-style contract, an administrative 'Exit fee' cannot be charged as a percentage of the credit advanced or the purchase price.

Discussion 4 & 5: The Draft Guidelines state: **(73)** An establishment fee is a fee or charge to a borrower that relates to costs incurred by the lender in connection with:

i) the application for credit;
ii) processing and considering an application;
iii) documenting a loan contract; and
iv) advancing credit to a borrower.

(74) These are the only costs that can be recovered through an establishment fee. Where costs are not connected to the four listed activities, they cannot be recovered as part of an establishment fee. They must be recovered through the interest rate or through another suitable credit fee.

For example, a finance company loaned on a car with cost price of $9,900, with an establishment fee at 23% which was added to the total debt and thus compounding. The finance company also required a $1,300 insurance policy that was also charged an establishment fee of 23%. This and other charges were then added to the compounding total charge.

Further, the Draft Guidelines state: **(75)** The prescribed test for determining the reasonableness of an establishment fee provides that, in determining whether an establishment fee is unreasonable the court must have regard to

(a) whether the amount of the fee is equal to or less than the lender's reasonable costs in connection with the application for credit, processing and considering that application, documenting the consumer credit contract, and advancing the credit; or

(b) whether the amount of the fee is equal to or less than the lender's average reasonable costs of the matters referred to in paragraph (a) for the appropriate class of consumer credit contract.

Submission 4: An establishment fee is a fixed cost and not based on a percentage of the total borrowing.

Submission 5: That where insurance is required as part of a credit contract, it is the burden of the borrower to provide that insurance and the cost is included in the deposit and excluded from any percentage-based establishment fee.

Submission 6: That consideration be given to the total amount of 'establishment' fees where the accumulation of such additional individual charges is oppressive to the borrower.

Discussion 6: The Draft Guidelines state: **(101)** As is noted in the Code, where the lender provides this insurance, the lender may also recover an amount that reflects the risks insured against.

Taking the example of payment protection insurance charged by a lender known to NTM, where the borrower was receiving ongoing Work and Income support, a fee of $350 (charged in this actual case) is not reasonable nor commensurate to the risk, where the likelihood of loss of income of the borrower is low in this specific instance.

Submission 7: That where insurance premiums are charged to protect lenders from non-payment, a proper and accurate assessment of the risk be undertaken, based on the individual circumstances of the borrower.

Discussion 7: The Draft Guidelines state: **(129)** Default fees are fees payable on a breach of a credit contract by a borrower or on the enforcement of a credit contract by a lender, but do not include default interest charges. Outsourced collection functions, relating to steps taken to enforce repayment of a debt, are costs that come within the definition of a default fee. **(130)** Similar to credit fees, the Act provides two considerations for determining the reasonableness of a default fee: **(44A(1))** [Reasonable compensation] In determining whether a default fee is unreasonable, the Court must have regard to, in relation to the matter giving rise to the fee, whether the fee reasonably compensates the lender for the following: (a) any cost incurred by the creditor; and (b) a reasonable estimate of any loss incurred by the creditor as a result of the debtor's acts or omissions. **(44A(2))** [Commercial practice] In determining whether the fee reasonably compensates the creditor for any cost and loss referred to in subsection (1), the court must have regard to reasonable standards of commercial practice.

Submission 8: That the default fee is a fixed charge, eg, Spark charges a late payment fee of $10.00 to cover their costs. The default fee cannot be percentage-based on the total debt outstanding.

Discussion 8: The Draft Guidelines state: **(136)** A default interest rate is a higher interest rate charged if a borrower breaches a credit contract, such as by missing payments or going over a credit limit. There is no restriction under the Act as to the default interest rate that can be charged provided that: **(136.1)** it is disclosed. **(136.2)** is not oppressive. **(137)** For loans entered into on or after 6 June 2015, default interest can only be charged while the account is in default and only on the amounts in default, not on the whole amount of the loan.

Submission 9: That <u>either</u> a default fee <u>or</u> a default interest rate can be charged on any amount in default, and a default rate can only be charged on the amount in default.

Discussion 9: The Draft Guidelines state: **(139)** The Act recognises that under some loans fees are payable to third parties (third party fees) that a lender is permitted to pass on to the borrower…. **(140)** Third party fees are fees or charges for amounts paid by the lender to another person, body or agency, for which the lender is entitled to seek reimbursement from the borrower. **(141)** Common third party costs include: **(141.1)** the costs of collecting overdue repayments; **(141.2)** credit-related insurance paid to an insurer (where the insurance from that insurer is not required by the contract); **(141.3)** personal Properties Securities search or registration fees payable to Ministry of Business, Innovation and Employment; **(141.4)** mortgage registration fees payable to Land Information New Zealand.

We also note that: **(142)** For arms-length third party fees, the Act requires that: **(142.1)** a third party fee must not exceed the actual amount payable by the lender if that amount is ascertainable at the time it is charged to the borrower; **(142.2)** the fee charged must be set by taking into account any discount, rebate or allowance received or receivable by the lender or any related company; **(142.3)** where the fee is not ascertainable at the time it is charged, and the amount paid by the lender to the third party is less than was charged to the borrower, the lender must immediately refund or credit the difference to the borrower. Also: **(143)** Where a third party fee is paid to an "associated person" of the lender the fee will be a credit fee and must be reasonable – it cannot simply be passed on at cost, unless it is reasonable; and: **(144)** Third party default fees must be reasonable whether or not they are paid to an associated person.

The lender is generally not subject to high interest costs on the charges of third parties, thus has no justification in accumulating such interest costs against the borrower.

Submission 10: That third party fees on-charged to the borrower shall be verifiable, reasonable, and exclusive of interest charges.

Discussion 10: The Draft Guidelines state **(151)** A lender must disclose all fees to be charged under a consumer credit contract and this disclosure must not be likely to deceive or mislead the borrower. Clear disclosure is also a requirement of the Principles. **(152)** The description of a fee must accurately reflect the activity to which the fee relates, and must not be misleading as to the activities encompassed by the fee. Obscurity in fee descriptions can impede the statutory purpose of allowing consumers to readily compare credit offerings. **(153)** There are significant consequences for breaching the fees provisions.

An actual example from NTM arose where a car dealer required a compulsory 'extra' mechanism to be installed in a borrower's vehicle, being effectively a shutdown mechanism should the payments to the finance company be in default. Furthermore, a rental of $5.76 was also required to be paid as part of the credit contract. This was not an optional service and would appear to fall somewhere between a form of insurance or 'other' credit fee.

Submission 11: While sections 151-155 provide guidance on Disclosure and description of fees, Penalties and consequences for unreasonable fees, greater clarity by way of examples on fringe practices with comments on their legality and recovery, is recommended. If fees are charged that are potentially obscure to a

borrower, information on their definition should be 'proactively' provided to the borrower at the outset.

In summary:

Submission 1: Include the 'total cost of credit' in the $ amount in the loan contract.

Submission 2: Include the 'total cost of credit' in the assessment of 'reasonableness'.

Submission 3: When concluding a layby-style contract, an administrative 'Exit fee' cannot be charged as a percentage of the credit advanced or the purchase price.

Submission 4: An establishment fee is a fixed cost and not based on a percentage of the total borrowing.

Submission 5: That where insurance is required as part of a credit contract, it is the burden of the borrower to provide that insurance and the cost is included in the deposit and excluded from any percentage-based establishment fee.

Submission 6: That consideration be given to the total amount of 'establishment' fees where the accumulation of such additional individual charges is oppressive to the borrower.

Submission 7: That where insurance premiums are charged to protect lenders from non-payment, a proper and accurate assessment of the risk be undertaken, based on the individual circumstances of the borrower**.**

Submission 8: That the default fee is a fixed charge, eg, Spark charge a late payment fee of $10.00 to cover their costs. The default fee cannot be percentage-based on the total debt outstanding.

Submission 9: That either a default fee or a default interest rate can be charged on any amount in default, and a default rate can only be charged on the amount in default.

Submission 10: That third party fees on-charged to the borrower shall be verifiable, reasonable, and exclusive of interest charges.

Submission 11: Greater clarity by way of examples on "fringe practices" with comments on their legality and recovery, is recommended. If fees are charged that are potentially obscure to a borrower, information on their definition should be 'proactively' provided to the borrower at the outset.

Other comments from NTM's experience

NTM receives settlement statements from lenders to enable the total debt at a point in time to be satisfied and be replaced with a no interest loan. Our experience in receiving such statements is highly variable as to the adequacy of their disclosure of all charges incurred and the consistency of language used.

We suggest that clearer guidelines in the area of Settlement Statements be drafted as an addition to the Consumer Credit Fees Guidelines, in particular that the total fees (and interest) charged in the period of reporting be fully itemised and disclosed, under the same name and description as in the original contract and client statements.