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16 December 2014

The Responsible Lending Code
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Responsible Lending Code – consultation draft

The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the Ministry of Business, Innovation and Employment's draft Responsible Lending Code, including explanatory material for the draft Code (draft Code).

General comments

The Law Society welcomes the draft Code's clear and easy to follow structure. In particular, the clear differentiation between the principle, commentary and guidance in each section makes the overall Code easy to follow.

Overall, the Law Society considers the draft Code will greatly improve protection of consumers, promote their confident and informed participation in credit markets, and promote and facilitate fair, efficient and transparent credit markets. It achieves this through an appropriate balance of lenders' obligations and borrowers' responsibilities.

Our one overall concern as to structure is the length of the draft Code. We suggest that the online version of the Code allows for drop downs and click-throughs where appropriate, so that the draft Code is more digestible to online readers.

Questions for submitters

Our submission does not respond to every question. References below are to the consultation questions, and paragraph numbering corresponds to sections of the draft Code.

1. Introduction

1.1–1.3 The Law Society welcomes the clarification in the draft Code that there are no "safe harbours".

However, the Law Society suggests that the draft Code wording should reflect the exact wording of the Credit Contracts and Consumer Finance Amendment Act 2014, so that paragraph 2 (page 3) would read "However, evidence of compliance with the provisions of the Code is to be taken as evidence of compliance …".

We also suggest expanding this section to explain that mere evidence of compliance does not mean the lender has followed the lender responsibility principles but that this will be taken into consideration and weighed against other evidence in making such an assessment.

Overall, the Law Society believes the draft Code strikes an appropriate balance between consumer protection, certainty for lenders and minimising compliance costs.

2. Obligations that apply before and throughout the agreement

2.1 Our comments relate to guidance paragraphs 2.3 and 2.4. It may be useful to include in the guidance requirements a reminder that for larger lenders the policy should include high level reporting to the board (or other governance body) and trend analysis including as to the background of borrower default. It may be that this can be included as a matter of record-keeping at paragraph 2.9 whereby a lender keeps a record not only of its policies but also analysis of default trends and reporting to its governance body. The extent and level of reporting will of course depend on the size of the lender.

In addition, in terms of paragraph 2.9(b)(ii), a record should also be kept of the corrective action taken after a breach, and of any trend analysis in relation to breaches.

Finally, guidance paragraph 2.8 states that lenders should contact a borrower or guarantor "at reasonable hours (i.e. between 6am and 9pm), taking into account their circumstances and reasonable wishes". What counts as a "reasonable" contact time will depend on the individual: although many people would not regard a call at 6am as reasonable, for others (such as shift workers) a call at that time may be convenient. Since the guidance does require individual circumstances and wishes to be taken into account, it may be better simply to delete the words in brackets "(i.e. between 6am and 9pm)".

3. Advertising

3.1 The Law Society recommends that the rider in paragraph 3.2(a) of the draft Code, "other than puffery (i.e. obvious exaggeration)" should be deleted. We acknowledge this is the legal position, but it is somewhat confusing to include it. In any case, it is doubtful whether puffery can have a realistic place in credit advertising.

Paragraph 3.2(c) requires lenders to "disclose any conditions that are unusual, inconsistent with, or modify, in an unexpected manner, the main message of the advertisement". The Law Society recommends the following additional words, to highlight that the borrower's perspective is what counts: "disclose **and highlight** any conditions that **– from a reasonable borrower's perspective –** are unusual [etc]".

In terms of the guidance set out at paragraph 3.4 regarding specific practices, the Law Society considers there is merit in including reference to visual representation; for example, showing the cost of the loan broken down by interest, fees and other expenses over the life of the loan by way of a pie graph. Visual graphics can be particularly useful for communicating to vulnerable individuals in the case of high-cost, short-term credit arrangements.

3.6 The Law Society agrees that all advertising of high-cost, short-term credit agreements should carry a risk warning due to the high costs associated with this lending. It agrees the words of warning should be prescribed by the Code, and refers to its comment above regarding the utility of visual information as well as words. It would be helpful if the prescribed wording included a suggestion to borrowers that they first seek budgeting advice.

4. Inquiries into and assessment of borrower's requirements and objectives

4.1 The Law Society considers that the qualifying words “where relevant” in guidance paragraph 4.1 should apply only to paragraphs (d) and (e), as it considers that paragraphs (a) to (c) would always warrant lender inquiry. For example, the amount of credit sought should always be the subject of inquiry, and should always be taken into account by the lender. Likewise, whether that credit is required on a one-off basis and the timeframe for which it is sought are always relevant.

5. Inquiries into and assessment of substantial hardship (borrowers)

5.5 The Law Society considers option 2 is preferable. Option 2 clearly sets out the relevant factors – namely whether repayments can be made without further borrowing or being forced to realise security or assets.

5.9 The Law Society considers it highly likely that paragraphs (a), (b), (c), (f) and (i) of guidance paragraph 5.2 will always be relevant. The Law Society also questions the categorisation of child care as “other regular expenditure” (paragraph (d)) rather than "non-discretionary" (paragraph (c)): for many borrowers, child care is non-discretionary in that without child care, the borrower cannot work.

6. Inquiries into and assessment of substantial hardship (guarantors)

The Law Society has no specific feedback on questions 6.1 – 6.7, other than to say it believes section 6 of the draft Code is generally appropriate. See also the previous comments (paragraph 5.9 above) relating to paragraph 5.2 of the draft Code.

7. Assisting borrowers to make an informed decision

7.1 Guidance paragraphs 7.17 – 7.19 outline the requirement for the terms of the agreement “to be expressed in plain language in a clear, concise and intelligible manner”, with “intelligible” requiring an “overall assessment of whether the terms are understandable and comprehensible”. The Law Society questions whether the word "intelligible" defined in that way sufficiently deals with the need for the lender to ensure that the borrower understands. As the commentary notes, the Financial Advisers Act 2008 uses the wording ‘clearly, concisely and *effectively*’, which would require that as far as reasonably practicable the borrower understands the communication. The Law Society recommends that “intelligible” be defined as meaning the terms are “understandable and comprehensible *to the likely borrower*” (or, alternatively, “*to borrowers in the target market*”).

The Law Society reiterates its comment in paragraph 3.1 above regarding the value of visual representation of information, in relation to paragraph 7.2 of the draft Code.

8. Assisting guarantors to make an informed decision

8.1 The Law Society questions whether a more limited level of assistance and information is appropriate where the guarantor has previously given a similar guarantee (paragraph 8.11(b) of the draft Code). If that earlier guarantee is in place, the effect of an additional exposure suggests that the guarantor may in fact be more vulnerable.

9. Credit-related insurance and repayment waivers

9.1 The Law Society notes that there is no explicit guidance regarding lenders disclosing commission they earn where they arrange insurance for borrowers. If the lender is arranging insurance, there is an inherent conflict in the commission it will earn and its ability to provide advice regarding insurance needs to the borrower. The lender must disclose the fact that commission will be earned on insurance (or any other independently supplied service such as extended warranties) it arranges on behalf of the borrower (Secret Commissions Act 1910 s 5(1)), or pass the commission (or any other benefit it receives) onto the borrower. Paragraph 9.10 of the draft Code may be an appropriate place to include this, or a new paragraph in section 9 may be required.

12. Default and other problems

12.1 In relation to the guidance on unforeseen hardship applications (paragraphs 12.10 – 12.14) it would be helpful to include the statutory definition of "unforeseen hardship".

When considering a proposed repayment plan as required at paragraph 12.11, the lender should also take into account the matters at paragraph 5.2 as to the borrower's ability to repay under the proposed repayment plan.

13. Repossession

13.1 In relation to the repossession process (paragraphs 13.9 – 13.11), guidance as to generally appropriate times for repossession (similar to those discussed at paragraph 2.1 above, for contact with borrowers) would provide the appropriate balance between enforcement of lenders' rights and protection of borrowers. Repossession should not for example take place at 5.30am except if there are exceptional circumstances (for example the borrower is the sole occupant and is known to work shift work and likely to be awake at 5am).

15. Glossary

15.1 The Law Society suggests that the definition of "high-cost short term credit agreements" should not be expressed definitively. We recommend the second sentence be amended to read "… high-cost short-term credit agreements **include** those agreements where …".

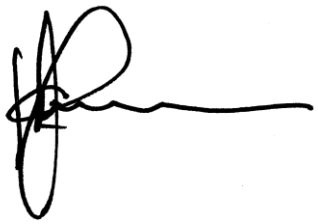
Pawnbroking

The Law Society questions the references to pawnbroking in paragraphs 5.8 and 7.2(a)(i) of the draft Code, as pawnbrokers are not "lenders" in terms of the definition set out in section 9B of the Credit Contracts and Consumer Finance Amendment Act. True pawn transactions fall outside the consumer credit contracts provisions of the CCCFA (see new section 15A). Nor do they fall under part 3A which addresses repossession: the pawnbroker already has possession of the goods. Further, a pawn transaction cannot be a buy-back transaction: this is specifically prohibited by section 55 of the Secondhand Dealers and Pawnbrokers Act 2004. Pledgers of goods by way of pawn are placed under no continuing obligations: they may choose to redeem goods or not. It would appear in any case that the Code has little relevance to pawnbrokers, who are strictly regulated by their specific legislation, including the essential requirements to explain properly and to document the pawn transaction.

Conclusion

This submission was prepared by the Law Society's Commercial and Business Law Committee. The convenor of the committee, Stephen Layburn, can be contacted through the committee secretary Vicky Stanbridge (vicky.stanbridge@lawsociety.org.nz / ph 04 463 2912).

Yours sincerely



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