FINANCIAL SERVICES FEDERATION

25 October 2016

Credit fees submissions
Commerce Commission
PO Box 2351
Wellington 6012

By email: creditfeessubmissions@comcom.govt.nz

The Financial Services Federation ("FSF") is responding to your recently-released draft guidelines on consumer credit fees.

By way of background, the FSF is the industry body representing responsible and ethical finance and leasing providers in New Zealand. The FSF has over fifty members and affiliates providing first-class financing, leasing, and credit-related insurance products and services to over 1 million New Zealand consumers and businesses. The FSF's affiliate members include internationally recognised legal and consulting partners. A list of the current membership is attached to this submission as Appendix "A".

Before addressing the specific contents of the draft guidelines, the FSF would like to take the opportunity to make some more general comments with regard to the current regulation of consumer credit fees in New Zealand. When the Credit Contracts and Consumer Finance Act ("CCCFA") was enacted in 2003, the CCCFA did not support the way in which consumer credit fees were to be regulated. In the FSF's belief it was a retrograde step to abolish the reporting of the finance rate as the means to demonstrate how much more than the principal amount being borrowed the consumer was having to pay.

In the opinion of the FSF this was a much more transparent way in which to allow consumer comparison between lender offers, as it bundled up all interest and charges and presented it in one rate that could be compared against that being offered by a range of lenders. At present consumers have to compare both the fees and interest rates being charged to determine which lender is offering the best deal for them.

The FSF does not believe either the current fees regime or the outcome of the *Sportzone* case has done anything to enhance the transparency or comparability of credit offerings to consumers. In fact quite the opposite is the case as the costs that are now clearly not allowed to be included in the credit fees have to be included in the interest rate in order for them to be recovered by the lender, and will also vary from lender to lender.

This means that the interest rate now includes the cost of funds, allowance for the risk of the individual credit contract, the cost of providing the credit that are not included in the credit fee and whatever profit the lender is going to make.

It is also interesting to the FSF that credit fees have been the subject of such a strong regulatory regime when fees for other services such as legal fees (as an example but there are of course many others) are not.

The FSF does recognise that it is not at all likely that any change to the current regulatory environment in respect of credit fees will happen any time soon, although it considers this is unfortunate for both the consumer and the lender for the reasons stated above.

With respect to the draft guidelines, the FSF has the following specific points to make, after first noting that the Commission's 2010 draft fees guidelines never actually ceased to be "draft" which the FSF

believes undermined their utility as something authoritative that lenders could actually rely on. The FSF therefore hopes that it is the Commission's intention to remove the word "draft" from these guidelines once their consultation is finalised.

The FSF's comments specific to the draft guidelines is as follows:

1. **Para 6, footnote 7**: The paragraph cross reference in the footnote is wrong and needs correction.

2. **Para 11**: A small point, but section 41 actually says "provide for", not "providing for".

3. **Paras 12.3 – 12.5:** The paragraph cross references are wrong and need correction.

4. **Para 13**: The FSF does not believe it is not very helpful to say that ".. fees cannot be used to recover general business costs..". It is accepted that in the *Sportzone* case the Supreme Court did refer in one place to "general overheads" but if this document is going to be of assistance in giving guidance it needs to avoid such general language, particularly when some of the costs the Supreme Court permitted MTF to recover might fairly be regarded by many as being part of "general business costs."

   Perhaps this text should refer to something like "... general business costs that are not sufficiently connected to the relevant activity", which would more fairly reflect what the *Sportzone* case actually decided.

5. **Para 14, footnotes 10 & 11**: The footnotes seem to be in reverse sequence. (ie: section 9C(3)(f) relates to the first sentence of para 14, not the second, and vice-versa).

6. **Para 26**: The reference in this paragraph to the expected-loss approach applying equally to default fees is problematic in the FSF's opinion given that -

   a) a) disclosure of the fee must occur ahead of the default being incurred; and

   b) b) there are a number of unknown variables in determining the amount of the default loss, including the point in time at which the default occurs.

   The FSF therefore asks whether the Commission envisages that lenders will meet their disclosure obligations by either providing a schedule of potential lost interest income or will they provide a formula such as a safe harbour prepayment formula for calculating such income? The FSF would also be interested in how the Commission envisages that lenders would factor in loss attributing variables such as market price at the time of the loss incurred and damage repairs for example in the case of recovering the cost of default on a loan for a motor vehicle.

   Further, the FSF submits that third party collection costs should be explicitly excluded from default fees. These costs are not known at the time of credit origination, are incurred as an arms-length transaction and should therefore not be included as part of the test for reasonableness applied to default fees.

   Finally the FSF submits that it can be argued that third party collection fees are already outside the scope of the definition of "default fees".

The statutory definition reads *"default fees means fees or charges payable on a breach of a credit contract by a debtor or on the enforcement of a credit contract by a creditor; but does not include default interest charges"*. Clearly the costs associated with debt enforcement agencies and so on do not come within the first limb of the test, as they are not payable at the moment of breach, only if a creditor can't otherwise resolve the matter with the debtor. But it doesn't seem entirely clear which collection related costs come within the *"enforcement of a credit contract by a creditor"*. It seems clear from other references in the legislation that formal steps such as repossession would come under the heading of "enforcement", but a simple collection letter, for example, may not.

7. **Para 35**: The FSF submits that to say that the "costs that the High Court disallowed included the costs incurred in advancing funds…" is again unhelpfully general, given that some of the costs the Court permitted MTF to recover were definitely "costs incurred in advancing funds…" (such as bank charges). If as footnote 32 suggests what is being referred to here is para [69] of the High Court liability judgment, then it is suggested that "treasury costs" should replace "costs incurred in advancing funds…" in this text.

8. **Para 37**: The FSF believes that the future utility of this quote is questionable, as the previous text of section 41(2) is central to the quote, but following the 2015 amendments to the CCCFA there is no longer any section 41(2), and section 41 no longer refers to any ability to "annul" a fee either, at least not in the terms quoted. The FSF therefore suggests that this paragraph could be deleted in its entirety from the guidance.

9. **Para 43:** This refers to ".. an expectation that lenders …. will adopt cost saving practices. when these become reasonably available." It is not clear to the FSF whose "expectation" is being referred to, but there is nothing in Supreme Court's judgment to suggest it was that of the Supreme Court, and nothing in the CCCFA itself suggests this was Parliament's intention.

   The CCCFA may tie fees to closely connected costs, but it does not place any onus on lenders to actively seek to manage their costs down, and it would be drawing a long bow to suggest that is somehow implicit in the requirement that fees be "reasonable".

   If this expectation is that of the Commerce Commission, the text should say so, but preferably it should simply be deleted as being unjustified.

   The FSF would further make the point that this comes dangerously close to the Commission dictating acceptable business models for lenders. It could be said that manually processing a loan application could be deemed to be unreasonable because a lender has not adopted a cost saving practice that is available to other lenders. A lender may have valid reasons other than just cost, such as risk management, for not adopting "cost saving practices, technologies and structures".

   On the other hand initial investment in business practice, structure or systems not used by other lenders will be "outside the commercial norm" and therefore the Commission could seek to limit investment on the basis of additional cost incurred, even if there is a benefit to the borrower from the additional investment.

10. **Paras 44 and 45**: The FSF submits that the heading "Deterrent fees are unreasonable" is not justified by the actual provisions of the CCCFA. Default fees may well have a deterrent effect for example and quite likely usually do, but they will still be valid if they meet the requirements of the relevant sections.

    There are undoubtedly default fees that may have a deterrent effect and which do not exceed a lender's costs at all. These two paragraphs should be deleted as being unjustified and presently seriously lacking in balance.

11. **Para 48**: The FSF questions how the Commission expects that a consumer will know if the fees a lender charges are reasonable and whether the only avenue available to consumers and other lenders to determine this would be a complaint to the Commission. As a suggestion the Commission could publish a register of lenders it has reviewed and who it considers are compliant with the *Sportzone* precedent. The FSF suggests that this could operate in a similar way to the Department of Internal Affairs' bi-annual audit of AML/CFT compliance and risk assessment.

12. **Para 57**: The FSF submits that the statement that it is "unlikely" that a percentage fee will equate to (or be less than) a lender's costs is again an assertion that is unlikely to be universally correct. It would be preferable for this language to be replaced by text to the effect that a percentage fee will only be valid if it produces a charge that is, or is less than, the lender's recoverable costs for the relevant activity.

13. **Para 63**: The FSF submits that reference to costs needing to be "transaction-specific" could easily be misunderstood as referring to fees needing to be based on the actual costs of an actual transaction, rather than on an average cost computed by reference to anticipated volumes of transactions of a particular type, which is clearly permitted.

    Here and elsewhere where the expression "transaction-specific" is used, the FSF suggests it should be replaced with something that better reflects that point. Perhaps ".. costs specific to typical transactions of that type…".

14. **Paras 64 – 71**: The FSF notes that these paragraphs emphasise how the Commission considers "these accounting concepts can be of some use," which is much the same thing as saying that the Commission thinks they can be "helpful."

    That is the opposite of what the Supreme Court said at para 114 of its judgment when it said it did *not* think these concepts were "helpful". While the first sentence of para 64 is good in so far as it is intended to reflect the Court's reservations about the utility of these accounting concepts, the FSF believes the text still tends to understate the Supreme Court's reservations.

    The FSF therefore suggests that this language should be revised so as to more fairly reflect what the Court actually said with regard to the only test being whether the cost meets the close relevance test.

15. **Para 85**: The FSF notes that this paragraph suggests that "borrowers with different credit profiles" should be treated as different classes of contract having different fee structures. That seems surprising, and might even imply that the Commission thinks that borrowers with poorer credit profiles could be charged higher fees.

The FSF therefore suggests that this paragraph is not correct and that, for example, new vehicle purchase finance is only one class of contract, despite the fact that there may be a wide range of borrowers with differing credit profiles seeking that type of finance.

Para 84 of the Guidelines states that *"An appropriate class of credit contract will be a group of contracts that are similar in nature and are likely to attract the same type and level of costs."*

This suggests that if a lender can identify a "class" that attracts a different type or level of costs it will be appropriate to charge that "class" a different level of fee to other classes, but not solely on the basis of a different risk profile.

16. **Para 86 – example**: The FSF submits that the example at para 86 would be improved if the reference to security registration costs were removed from it, as they are third party charges subject to different criteria from those applicable to establishment fees. This could be interpreted as a departure from the class of loan approach for cost allocation and therefore moving towards a bespoke actual cost per transaction approach. The High Court judgment in the *Sportzone* case determined that it was appropriate to recover third party costs through an establishment fee.

17. **Para 87 – Table 1 - Establishment fees**: Several comments about Table 1:

    a) Depreciation: The FSF submits that the statement that "The lender cannot claim depreciation on assets where the cost of those assets has already been recovered by fees or some other means" has significant capacity to confuse and complicate, because many lenders may seek to recover some depreciation in their tax returns

       However, any such recovery will generally follow the charging of the corresponding fees rather than predating them, so if there is any issue here it may be as to the ability to subsequently claim a tax deduction, rather than as to how to compute the fee in the first place. The FSF accordingly suggests that these Guidelines can and should keep out of tax issues like this, and that this sentence should be deleted;

    b) Administration costs: As already noted at 4 above, the reference to "general overheads" is unhelpfully general;

    c) Head office costs: The FSF submits that "Head office costs" may mean different things to different people and it would be desirable to be more precise about what is meant here, which the High Court's judgments definitely make possible;

    d) Return on capital/cost of capital/ Treasury costs: The FSF submits that the text opposite these three things seems to envisage that all of them are "profit", whereas only the first of them is akin to profit – the other 2 are costs, even if not recoverable costs. The FSF suggests that maybe "Return on capital" could be relocated into the heading to the next box, which would then become "Profit and Return on capital"?

    e) Costs relating to lenders' funding arrangements: The FSF submits that these are already adequately covered by "Treasury costs" earlier, and there is no need to repeat them here.

18. **Para 105 – example**: The FSF submits that the example at para 105 is not very apt, as the fees charged for an overseas withdrawal may well be or include the fees of the offshore bank operating the ATM, and they may either not be subject to the CCCFA at all, or may be subject to a different regime as third party charges.

19. **<u>Para 106 – Table 2</u>**: Costs relating to lenders' funding arrangements: Comment should read "*These are general costs of the lender's business and do not relate to a particular loan."* The statement as worded in the draft guidelines does not make sense. If they are not general costs, then they are specific costs and will relate to specific loans.

20. **<u>Para 111</u>**: The FSF submits that when the second bullet point begins by saying that a prepayment fee can only be charged when it is "no more than" the lender's loss from the prepayment that is not what section 51 says. Section 51 actually refers to a permissible prepayment fee being "a reasonable estimate" of the lender's loss, which might in some cases be more than actual loss. Para 114 of the Guidelines makes this point correctly, but para 111 still needs revision in order to more accurately to reflect what the CCCFA says.

21. **<u>Para 123</u>**: This states –

    > "Importantly, any alternative procedure to the safe harbour formula must contain a mechanism to mitigate the lender's loss."

    The FSF submits that does not seem to be required by the CCCFA, nor does it appear to reflect anything said by the Court in *Avanti*, where the lender still succeeded despite the Court noting that it was *not* in a position to mitigate its loss by relending.

    The same comment also applies to much of paras 124 – 128, and also to paras 125 and 134 in particular. The most that can be said about a mitigation requirement in the context of *Avanti* is that the Court noted that loss mitigation might be relevant to what is and isn't a "reasonable" fee. It did not say that a mechanism to mitigate loss "must" be contained in the formula. The FSF suggests that these paras should be recast so as more fairly to reflect the relevant parts of the *Avanti* decision, or more clearly to reflect that this is simply the Commission's view of what is required, if that is what it is.

    It may also be worth noting that in so far as this section of the Guidelines is based on common law principles about liquidated damages clauses, those common law principles have recently been the subject of authoritative decisions in both the UK and Australia that post-date *Avanti*, including in the context of consumer credit.

22. **<u>Para 134</u>**: Similar comments apply to what is said about common law principles in para 134, which again cites *Avanti* as authority, but this time in the context of default fees. *Avanti* did not concern default fees at all, and is not authority for what this para says in this context: a prepayment does not involve "default" of any kind but is instead the exercise of a statutory right, which is actually a further reason why the common law rules about damages for breach are of limited relevance in these contexts: full prepayment is not a "default".

    The FSF submits that if the Commission thinks there is other authority for what is said about default fees at paras 134 and 135, it should cite it. If there is none, these paras should then be deleted as they do not seem to be justified by authority that is relevant in this context.

23. **<u>Para 138 – Table 3 - Default fees</u>**: The first line of Table 3 concerns debt recovery costs and says –

    > "If the debt recovery costs closely relate to the particular borrower's acts or omissions, an appropriate apportionment may be charged."

    The FSF suggests that that seems too limiting, and more limiting than the CCCFA actually is. If "the debt recovery costs closely relate to the particular borrower's acts or omissions" surely <u>all of them</u> can be charged, and issues of apportionment should not need to be considered at all. That was in fact

what the corresponding part of the Commission's 2010 draft fee Guidelines said on this issue, and it does seem to have been more correct than this text.

Further, the FSF submits that, as per the comments regarding Para 26 above, clarity should be provided with regard to the recovery of third party costs of collection and therefore should not be included as part of the test for reasonableness.

24. **Para 144:** The FSF submits that the Guidelines lack clarity in relation to the test for reasonableness for third party fees such as collection fees.

    The FSF does not believe the guidance in relation to "reasonableness" within the Guidelines and the current law can be applied to third party fees which are incurred as part of an arms' length transaction. Lenders have little control over third party fees incurred as part of an arms' length transaction, those fees are set by third party service providers in accordance with the market for those respective services (those fees include the general costs of doing business for those service providers, overheads and to derive a profit). Therefore the FSF suggests the appropriate test for reasonableness in relation to third party fees incurred as part of an arms' length transaction should be the same as the statutory criteria in section 45, as referenced in para 142 of the Guidelines.

The FSF trusts that its above responses are helpful, and would be pleased to discuss further, if that would be of assistance.

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Membership List as at 30 June 2016   Appendix A

<table>
<tr><th>Debenture Issuers - (NBDT)
Non-Bank Deposit Takers</th><th>Vehicle Lenders</th><th>Finance Company
Diversified Lenders</th><th>Credit Reporting
Other</th><th>Insurance</th><th>Affiliate Members</th></tr>
<tr>
<td><u>Rated</u>
• Asset Finance (B)
• Fisher & Paykel Finance (BB+)

<u>Non-Rated</u>
• Mutual Credit Finance
• Gold Band Finance Limited</td>
<td>• BMW Financial Services
• Branded Financial Services
• Community Financial Services
• Go Cars Finance Ltd
• European Financial Services
• Mercedes-Benz Financial Services
• Motor Trade Finance
• Nissan Financial Services NZ Ltd
• Onyx Finance Limited
• Toyota Finance NZ
• Yamaha Motor Finance
<u>Leasing Providers</u>
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• Fleet Partners NZ Ltd
• LeasePlan NZ Ltd
• ORIX NZ
• SG Fleet</td>
<td>• Advaro Limited
• Avanti Finance
• Caterpillar Financial Services NZ Ltd
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• Personal Finance Ltd
• South Pacific Loans
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• Thorn Group Financial Services Ltd
• Turners Finance Limited</td>
<td>• VEDA Advantage

<u>Debt Collection Agencies</u>
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• Consumer Credit Management Limited
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