

**Paula Rebstock Speech Notes**  
**“Commerce Commission: Regulation and Enforcement in the Finance Sector”**

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Good morning and thank you for inviting me to speak to you today.

I have been asked to speak to you about the Commerce Commission’s role in promoting compliance with the Credit Contracts and Consumer Finance Act in the finance sector.

You will all be familiar with this Act to a lesser or greater degree. But I want to impress upon you today, the importance of this legislation, our role in ensuring that its objectives are achieved and what issues have come to our attention.

**Competition and the Role of the Commerce Commission**

When thinking about the Commission’s role in enforcing the CCCF Act, it is important to see that role as one component of our wider purpose, which is to promote competitive markets in New Zealand.

In talking about the wider role of the Commerce Commission, I have to begin by saying the Commission is unashamedly pro-market, because of the benefits competition brings. A free market economy is the best way to allocate a country’s precious resources, and can deliver lower prices, innovative products and more choice.

Competition is the basic underpinning of a market economy. Indeed, it is such a basic fact of economic life that it is easy to take for granted. But consider for a moment how elegant the process of competition is, at least in principle. Firms compete on their merits to attract the customer's dollar. Those that best meet customer demand—in terms of price, quality and service—are rewarded with higher sales and profits. They attract investment and thrive. Those that do not are starved of business and go under, freeing up resources for the use of more efficient operators.

And a competitive market is, to a large extent, self-regulating. The market itself offers both carrots and sticks to encourage the best from everyone.

The most obvious benefit of competition is the pressure it exerts to lower prices and raise quality, because customers 'vote' with their dollar for the best and lowest cost offerings. Competition also encourages productivity by creating incentives to work smarter, and enabling company performance to be measured against the performance of competitors. Encouraging innovation is another direct benefit of competition, as companies try to out-think each other, and take up new technologies quickly, before their competitors.

### **Competition Law and Consumer Law**

To deliver these benefits, competition needs to be facilitated through robust legal frameworks. As I'm sure you all know, the Commerce Act is the Act designed to preserve competitive markets in New Zealand.

But there are two other Acts that also promote competition in New Zealand: the Fair Trading Act and CCCFA. Some see these Acts as consumer protection, but to the Commission their role is to help protect the competitive process.

Consumers help to drive competition through their choices. And consumers can only send the right signals to firms if their choices are founded on accurate information. They depend on companies to provide much of that information, but companies cannot always be relied on for accuracy.

Several high profile cases in the last year show how misleading behaviour by firms disempowers consumers, disadvantages competitors, and thereby undermines the competitive process. Banks and airlines had no incentive to lower fees while those fees remained hidden from consumers. Carter Holt Harvey was not pressured to deliver timber that met the grade as long as falsely labelled below-grade timber was attracting the same premium price. And who can forget Teresa Gattung's<sup>1</sup> statement in 2006 about pricing information in the telecommunications industry: "Think about pricing. What has every telco in the world done in the past? It's used confusion as its chief marketing tool. And that's fine."

It is hardly surprising that consumers become cynical about the information they receive, even when dealing with New Zealand's biggest companies. To play their part in the competitive process, consumers must be able to trust the information they get, which is why the Commerce Commission places a high priority on enforcing the Fair Trading and CCCFA Acts.

### **The CCCF Act and the Role of the Commerce Commission**

With respect to the CCCF Act, accurately informed consumers are better able to make choices about the relative costs of competing credit products. The exercising of choice should incentivise credit providers to compete vigorously, but lawfully (which is also the Commission's concern).

As the enforcer of the CCCF Act, the Commission aims to prevent or deter future breaches and encourage compliance with the Act. We take action to stop breaches and to ensure consumers are compensated or refunded, where possible. We also monitor trader practices within the credit markets in relation to these transactions.

In taking enforcement action, which may include criminal prosecutions, civil remedies, settlements with undertakings and warnings, we seek not only to change the conduct of a particular trader, but to effect industry-wide change.

And, to ensure that businesses understand both their obligations and the Commission's approach to enforcement, the Commission will, from time to time, publish guidelines and take opportunities such as this one to speak directly to the industry.

### **What the CCCF Act Does**

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<sup>1</sup> Teresa Gattung Statement

I am aware that some of you will be more familiar with the CCCF Act than others. For those who do not work with the Act on a daily basis, I will briefly recap what the CCCFA sets out to achieve.

In essence, the Act establishes minimum standards of conduct for credit providers in relation to their dealings with debtors.

These standards place obligations on credit providers to disclose specific information to consumers at given times. They do not place any thresholds on interest rates, but do require fees to be reasonable. In addition, they set out rules in relation to payments made by debtors under credit transactions, and create specific consumer rights that credit providers must be aware of and must not breach. These include the right to:

- be able to repay loans early;
- cancel loans in limited circumstances;
- vary loans in circumstances of hardship;
- obtain a review by the courts if credit providers refuse to consider hardship applications to vary loans, and the right to
- obtain legal advice when entering buy-back transactions of land.

The provisions of the Act relate to transactions with debtors who enter into consumer credit contracts, consumer leases, buy back transactions of land and, to a limited extent, commercial credit contracts.

***[Commercial Credit Contracts***

***Definition:*** *The Act sets out types of contracts included under the disclosure, fees and oppression provisions of the Act.*

*It also excludes a number of transactions from being covered under the disclosure and fees provisions. These contracts are covered only under the oppression provisions of the Act. These provisions enable the Court to re-open the contracts and rewrite the offending provisions.*

*Transactions specifically excluded from the CCCF Act include those transactions entered into by debtors for investment purposes (excluded under section 12), those transactions where the debtor is a trustee under a trust - s15 (i.e. a home loan will be excluded if the property is owned by a family trust, and the debtors are the trust's trustees), where an unarranged overdraft occurs (s15), a contract for the sale of property or provision of services where the agreed price is to be paid within two months will also be excluded (i.e. a property sale where the sale settles within 8 weeks as normal will not be considered to be a contract covered by the Act). ]*

*The Act requires that debtors enter the contracts primarily for personal, domestic or household purposes so all lending where the debtor is effectively operating a business will also be excluded from the core provisions of the Act.*

## **Relationship with the Fair Trading Act**

No discussion of the CCCF Act would be complete, though, without touching on the Fair Trading Act, which the Commission also enforces. The Fair Trading Act prohibits traders from making false or misleading representations to consumers, and this Act applies more generally to all traders, including those in the credit industry. It particularly applies in the finance sector where a creditor misleads a debtor about the creditor's ability to enforce provisions of a credit contract where, in reality, because of non-compliance with the CCCF Act, the contract is unenforceable.

## **Commission Activity**

I would like to review what the Commission has been doing since the introduction of the Act.

We have been enforcing the Act in relation to buy-back transactions since October 2003, and since April 2005 for the remaining types of transactions.

We began by conducting a wide range of seminars to which all known industry members were invited. This was followed by the publication of guidelines and by a number of "voluntary inspections". These inspections were designed to bring compliance issues to the attention of the individual credit providers and to inform the Commission about the level of compliance and the nature of existing compliance issues.

The Commission has also worked with a number of front-line consumer organisations to identify breaches of the Act, particularly those affecting the most vulnerable debtors.

After the initial compliance focus, litigation became a priority for the Commission. This was because we needed to establish precedents to clarify the law and also because our surveillance activity revealed a need to improve industry-wide compliance.

We are increasingly shifting resource from education into the enforcement area. The Commission's actions in the credit industry to date have so far resulted in Court ordered fines of \$159,000 against non-compliant credit providers, and voluntary and Court ordered refunds in excess of \$1 million being made to over 4,400 debtors.

## **Initial Priorities**

Our initial priorities were on obtaining compliance with the disclosure requirements, and compliance with the provisions relating to pre-payment of loans and on clarifying the law with respect to the reasonableness of fees. I will now briefly outline our action with respect to each of these areas.

## **Disclosure**

A requirement to disclose certain information to consumers is the cornerstone of the Act. The Act requires that consumers are provided with key information. It also requires that this information is presented in a way that is “easily readable by a reasonable person”. In addition, the Fair Trading Act requires that the representations, including key information under the CCCF Act, are accurate and not misleading.

The Commission has taken a number of enforcement actions over the past year against credit providers who have failed to meet the disclosure requirements of the Act.

Our first prosecution under the Act related to Senate Finance. The credit provider was fined \$59,000 for failing to adequately disclose relevant information. Also, they refunded in excess of \$13,000 to seventeen debtors. In that case, Senate Finance provided credit finance to car buyers. Our investigation found that its disclosure documents had been photocopied and faxed back and forth between the credit provider and car yard and rendered illegible by the time they were provided to customers.

The document actually contained all the required information under the CCCF Act, but it could not be read. In one instance, a debtor reported being advised by the car salesperson to “use a magnifying glass” to read the documents.

The Commission successfully argued in court that the illegibility of the print meant that the disclosure standards had not been met.

The CCCF Act requires not only that disclosure of specified information is provided to debtors within given timeframes and upon certain events but also that the disclosure documents in question must be produced in a font that is “easily readable by a reasonable person”.

The Act also prohibits the enforcement of consumer credit contracts, guarantees, consumer leases or buy-back transactions until adequate disclosure is made by credit providers. This is where the Fair Trading Act comes in, because credit providers attempting to enforce contracts in these circumstances may also breach the Fair Trading Act.

In the Senate Finance case, this was exactly what happened. Having provided disclosure documents to debtors, albeit ones that did not meet the required standards under the CCCF Act, Senate Finance then proceeded to attempt to enforce its rights under the loan agreements. In doing so, it breached the Fair Trading Act by making false representations that it had the ability to enforce the contracts at a time when such enforcement was prohibited. The steps Senate Finance took to enforce the contracts included issuing letters of demand, and issuing pre-possession and repossession notices.

The Commission has also come across other cases where credit providers have repossessed secured chattels and recovered funds from their sale, or referred debts to third parties for collection, despite not having made adequate disclosure.

There is a flow-on from this to debt collectors. It might be prudent for debt collectors to adopt a “best practice” model to ensure that the credit provider has complied with the disclosure provisions of the CCCF Act. This may ensure debt collectors do not inadvertently breach the Fair Trading Act by collecting debts under prohibited contracts. The message to debt collectors is clear - establish compliance systems in order to take reasonable precautions and exercise due diligence to avoid contravening the Fair Trading Act.

The Commission was also successful in convicting Auckland based Dolbak Finance, a partnership providing motor vehicle finance. Dolbak Finance had not changed its practices following the introduction of the CCCF Act, despite being aware of its introduction, and continued to provide debtors with contracts under the old Credit Contracts Act. Dolbak Finance was convicted for not meeting disclosure requirements under the CCCF Act, fined \$100,000 and ordered to pay statutory damages of \$46,600. As a partnership, the two partners are responsible for paying these amounts.

In the Commission’s third CCCF Act prosecution, an Auckland based credit provider, has entered guilty pleas to failing to provide disclosure, charging unreasonable credit fees and over-charging interest. We are awaiting the Judge’s reserved sentencing decision and will publicise further information when this is received.

In another case, in a completely different area of business, the Southland District Council was warned for breaching the disclosure requirements of the CCCF Act.

The Council established a scheme where ratepayers could make payments for infrastructure improvements to an existing sewerage scheme. The Council offered a range of payment options for ratepayers, including two options which allowed for loans to be paid off in instalments.

Both schemes were subject to the Act and the Council was, therefore, required to meet the same standards as any other credit provider.

The Council had provided some information to ratepayers about the scheme, but as it was not aware it was subject to the Act, it did not make disclosure in accordance with the Act.

More recently, the Commission has warned four credit providers operating “mobile shops” in the North Island for failing to comply with the Act’s disclosure provisions.

A further eight south Auckland credit providers have also been warned for failing to disclose adequately, and a ninth South Auckland credit provider is being prosecuted for alleged breaches of the Act’s disclosure provisions. Some of you will have seen the director of Funaki Enterprises on the television news, claiming that his company provided a ‘social service’.

In fact, these companies were providing personal loans to debtors at interest rates exceeding 30% without properly disclosing the contract terms and conditions, in particular the rights debtors have under the Act.

The Commission has also taken enforcement action against pawnbrokers failing to comply with the disclosure provisions of the Act. Pawnbrokers are covered by both the CCCF Act and the Secondhand Dealers and Pawnbrokers Act 2004. Some pawnbrokers had chosen only to comply with the latter Act and did not think they were captured by the CCCF Act, so did not provide the required disclosure. It is clear that pawnbrokers must comply with the CCCF Act and have been warned accordingly.

Credit providers are responsible for disclosure. If you rely on agents to provide disclosure documentation to debtors, it is important that you monitor the quality of the disclosure provided. Credit providers have been, and will be, held responsible for their agents’ non-compliance with the Act.

## **Prepayment of Loans**

I want to talk specifically about the issue of prepayment of loans.

The CCCF Act sets out rules relating to full prepayment of loans, where a debtor pays a loan off in full before the end of the loan term. The Act provides debtors with a statutory right to fully prepay loans and establishes rules for determining how much credit providers can charge debtors in those situations.

These rules include provision for credit providers to recover a reasonable estimate of their loss arising from the full prepayment, if their contracts expressly make provision for this loss to be recovered.

There is a “safe harbour” formula you can use to give a reasonable estimate of loss if a debtor fully prepays. The formula calculates the difference between the present value of outstanding loan repayments discounted at the prevailing interest rate and the lump sum repayment of the unpaid balance at the time of full prepayment. You do not need to use this formula, you can use any formulae which meet the requirements of the Act, but if you do use the safe harbour formula correctly, then the amount you calculate will be deemed to be a reasonable estimate of your loss.

The Commission has issued a warning to Primus Financial Services, trading as Ford Credit, which was charging more than the Act allows for prepayment.

In this case, Primus charged debtors all of the interest for the month in which the debtors prepaid rather than charging interest only up to the time of full prepayment. This is strictly prohibited under the Act. The credit provider took prompt action to remedy the breach and to refund \$49,000 to affected debtors.

The Commission has also taken enforcement action against a number of credit providers that included a provision for “time to re-lend funds” in their own full prepayment formula.

The Commission’s position on full prepayment is that, as a general principle, a credit provider may not automatically include an allowance for the time taken to re-lend funds.

Any estimate of loss should be calculated on the basis that credit providers take reasonable steps to mitigate their loss and re-lend money prepaid as soon as possible.

Credit providers choosing not to do so should be able to demonstrate that any delay in re-lending monies is unavoidable and be able to justify the extent of the delay.

The Commission is currently prosecuting Avanti Finance with regard to its estimate of loss on full prepayment. This matter will be the subject of a defended hearing in February next year.

The full prepayment rules under the Act also contain provisions relating to rebates of consumer credit related insurance financed under a consumer credit contract. The Act requires the use of a specific procedure for determining rebates in these cases.

The Commission has entered into a settlement with Gilrose Finance as they failed to comply with this procedure. Gilrose Finance returned over \$50,000 in overcharged premiums and other credit fees to over 2000 affected debtors.

Gilrose Finance took swift action to change its practices and refund affected debtors once the breach was drawn to its attention as a result of the Commission's investigation.

### **Unreasonable Requirements in Credit Contracts**

Finally on the subject of enforcement, the Act prohibits credit providers from making unreasonable requirements on debtors to take out credit related insurances, repayment waivers or extended warranties.

Requiring a customer to purchase these services will be considered unreasonable if the services are not reasonably necessary to protect the interests of the credit provider, or if they are not reasonably justifiable in light of the risks undertaken by the parties to the arrangement.

In the Commission's largest single settlement under the Act to date, Club Finance refunded \$788,000 in credit-related insurances, to debtors.

In that case, Club Finance required unemployed debtors to purchase insurance protecting them in the event of redundancy. A clause in the credit-related insurance contracts prevented debtors from being eligible for this cover, if they were not employed at the time they took the cover. In the circumstances, it was difficult to see either, how the debtor could benefit from the insurance, or how it provided protection for the credit provider.

### **Keeping the Industry Informed**

In September last year, we made available for the credit industry, information about some of the key areas of non-compliance we had identified during the course of our investigations. This information is currently available on the Commission's website and includes examples relating to specific investigations undertaken by the Commission.

Some of the key areas of concern included credit providers failing to realise their conduct was covered by the Act, or that there were substantive differences between the Credit Contracts Act and the CCCF Act. The District Council investigation I referred to earlier was an example of this sort of issue.

Other key areas of concern related to fees and credit-related insurances. Both of these areas are current target areas for our credit enforcement work.

Practices of "double dipping" on fees were also identified as an area of concern, where credit providers attempted to recover costs for one specific aspect of their

operation across a number of different fees, and effectively recovered the costs several times over.

We also identified a number of concerns about the recovery of specific cost components in various fees, in particular the recovery of costs for bad and doubtful debts in establishment fees, default fees or administrative fees.

The Act sets up a number of rules about fees that credit providers can charge debtors. It prohibits the charging of unreasonable credit and other fees.

While there is some scope as to how a Court will interpret whether fees are reasonable or not, we are currently using cost analyses obtained from credit providers to assess whether fees breach this prohibition.

We expect that credit providers will undertake a cost analysis exercise when setting and reviewing fees and will be able to fully justify any fee charged under a transaction subject to the Act.

Credit providers should take into account both the nature of the cost component and whether it is likely to be allowable under the relevant fee provisions of the Act, as well as considering the proportions of those costs recovered through fees. We may ask credit providers to justify both of these elements when we consider whether a fee is unreasonable.

The Commission has undertaken a number of enforcement actions against credit providers charging unreasonable fees and has recently entered into a settlement with The Motor Centre, a Blenheim based motor vehicle trader, for charging fees for services it did not perform.

The credit provider charged fees for searches of the Personal Properties Securities register, but then elected not to undertake the actual searches.

The Motor Centre also admitted to breaches of the Fair Trading Act for misleading debtors about who was actually providing the loan. The credit provider had used another credit provider's documentation, and the debtors were misled into thinking the loans were with the creditor whose logo was displayed on the documentation.

### **Current Priority Areas**

An analysis of the Commission's sources of information about compliance issues shows that failure to comply with the disclosure requirements, particularly initial disclosure, remains a problem.

Reasonableness of fees, particularly as these relate to establishment, default and early repayment fees, are also a continued source of complaint.

Accordingly, we have two priority areas for enforcing the Act over the next year. They are to take civil and criminal proceedings to reinforce the need for credit providers to comply with the disclosure provisions of the Act, and to establish precedents in relation to unreasonable fees.

We will also continue to work with consumer organisations to ensure credit providers, operating in the lower tiers of the credit market, comply with the Act. In order to do so, we will continue to take a balance of routine and high impact enforcement actions.

The focus of this enforcement action will be to ensure that conduct breaching the Act is quickly identified and ceases, and that affected debtors are compensated or receive refunds where appropriate.

In doing so, our objective is not only to ensure individual credit providers, subject to enforcement action implement appropriate compliance systems, but also to encourage the industry as a whole to respond to the guidance provided by the Commission's enforcement actions and the decisions of the Court.

It is reassuring to note that, to date, a number of credit providers have undertaken to refund debtors at their own instigation and have altered their conduct on the basis of relatively low level enforcement actions. In general, the Commission has received high levels of co-operation from credit providers during the course of its investigations.

The Commission also has a role in improving the financial literacy levels of consumers. We have been assisted in this through funds made available to consumer organisations as a result of previous Commission enforcement action. Those funds come from settlements achieved under the Fair Trading Act. Recently we have been distributing unclaimed compensation from settlements made with major banks over undisclosed overseas transaction fees on credit cards. To date over \$1.4 million has been distributed to projects benefiting consumers.

Specifically, these projects have included:

- \$200,000 to Plunket to provide a financial literacy module as part of its parenting education programme;
- Around \$144,000 to the Salvation Army to train its budget advisers;
- \$50,000 to the Consumers Institute to launch a Kiwisaver financial literacy tool on its website; and
- \$225,000 to the Retirement Commission for three research projects focussing on financial literacy.

## Conclusion

In conclusion, you can expect that the Commission will continue to take strong enforcement action where it identifies failure to comply with the CCCFA legislation. The Act has been in force for some three years now and we consider that all industry participants have had more than enough time to understand their obligations and ensure they comply.

To this effect, the Commission will continue to strengthen its relationships with a range of consumer organisations, to ensure it uncovers potential breaches, especially those affecting more vulnerable consumers. Assisting these organisations to educate consumers and make them aware of their rights is also expected to lead to greater competition as informed consumers will be better placed to choose between competing credit products, and hold creditors accountable for the accuracy of information.

In addition, we will be undertaking further work to clarify issues surrounding the reasonableness of fees. To achieve this, you can expect that we will take legal action where we believe that credit providers are being unreasonable.

Let me repeat that the Commerce Commission is unashamedly pro-market, because we believe that competition is the best way to allocate our scarce resources. Consumers and businesses do need protection, but they should be protected *through* market forces, not protected *from* them. To deliver the benefits of a market economy, markets must be dynamic, and the Commission's role is to deter anti-competitive and misleading conduct that would threaten the dynamic functioning of the New Zealand economy.

The desired result is a robust marketplace where firms that innovate and meet their customers' needs have the competitive edge. There is no question that a competitive market is a tough testing ground. However, well-informed consumers and exposure to competition are still the best guarantees that businesses will perform at a high level and deliver the quality of life that New Zealanders expect.

Thank you again for this opportunity to talk today. I am happy to take any questions you may have.