

SEPTEMBER 2022

Consumer Credit Fees Guidelines



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The Act and fees provisions

- 1 The Commerce Commission is responsible for enforcing the Credit Contracts and Consumer Finance Act 2003 (**the Act**), which applies to all lending within New Zealand.¹
- 2 The primary purpose of the Act is to protect the interests of consumers when they are borrowing money.²
- 3 One of the ways the Act achieves this purpose is by setting rules restricting the fees that lenders can charge over the life of a consumer credit contract.³ We refer to these rules as **the fees provisions**.
- 4 All credit and default fees charged under a consumer credit contract must be reasonable, and it is a criminal offence to provide for a fee that is unreasonable.⁴
- 5 The Act includes the Lender Responsibility Principles (**the Principles**),⁵ which set standards that all lenders must adhere to; they reinforce and require that lenders must comply with the fees provisions.
- 6 These guidelines were first issued following the Act's 2015 amendments and the Supreme Court judgment in the *Sportzone/MTF* litigation (**Sportzone**),⁶ and have been updated to reflect the new obligations from 1 December 2021 and recent credit fee and default fee investigation outcomes.⁷

Purpose and scope of fees guidelines

- 7 We have issued these guidelines to:
 - Explain the fees provisions.
 - Provide guidance on the kinds of costs and losses that can and cannot be recovered through fees.
 - Explain how we will assess whether a fee is lawful or unlawful.
 - Describe our approach to enforcing the fees provisions.
- 8 These guidelines are not exhaustive, nor are they intended to be legally binding.
- 9 These guidelines apply to all consumer credit contracts, whenever they were entered into, except in respect to third party fees. These guidelines apply only to third party fees payable under contracts entered into after 5 June 2015 or where noted otherwise.⁸

1. Borrowers and other parties to a consumer credit contract are also able to take their own action under the Act: s 95(1).

2. Section 3(1).

3. We use the term "lenders" to refer to creditors providing credit to borrowers under consumer credit contracts: s 9B.

4. Section 41 and 103.

5. Part 1A of the Act.

6. *Sportzone Motorcycles Limited (in liquidation) v Commerce Commission* [2016] NZSC 53 [12 May 2016] (**the Sportzone Supreme Court judgment**). See also *Sportzone Motorcycles Limited (in liq) v Commerce Commission* [2015] 3 NZLR 191 (CA) (**the Sportzone Court of Appeal judgment**); *Commerce Commission v Sportzone Motorcycles Ltd (in liq)* [2014] 3 NZLR 355 (**the Sportzone High Court liability judgment**); and *Commerce Commission v Sportzone Motorcycles Ltd (in liq)* [2014] NZHC 2486 (**the Sportzone High Court quantum judgment**).

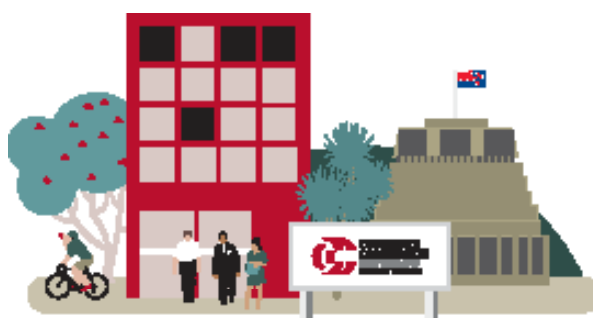
7. This includes material settlements and also the *Harmony Ltd v Commerce Commission* [2020] NZCA 275 (**Harmony**) decision.

8. The rules on third party fees were substantially amended in 2015. See [172]-[178] and [182]-[194] of these guidelines.

- 10 These guidelines contain examples which are intended to be indicative, and to help readers think about how the fees provisions might apply in realistic, but in each case hypothetical, situations. We acknowledge that any real-world fact pattern will be more complex, and that all the elements of the fees provisions would need to be considered in order to determine whether a fee is reasonable. Each case will need to be considered on its own facts.
- 11 We have also included tables to assist lenders to understand our position on different categories of costs. These tables are in summary form and are not exhaustive. They are intended to be indicative as to the types of costs that may or may not be recoverable through fees charged to borrowers.
- 12 The Commission will continue to seek to clarify the law through the courts, in suitable cases that meet our published enforcement criteria.⁹ We may revise the guidelines from time to time in accordance with legal developments and our organisational objectives and priorities.
- 13 Where any party brings proceedings, it is for the courts to interpret the fees provisions. These Guidelines reflect the Commission's enforcement approach to fees, taking into account the provisions of the Act, the Lender Responsibility Principles and the Responsible Lending Code (**the Code**).

Contents of guidelines

- 14 These guidelines are structured as follows:
- 15-19** Consumer protection is the primary purpose of the fees provisions
 - 20-23** Lender Responsibility Principles and Responsible Lending Code
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 - 196-197** Penalties and consequences for unreasonable fees.



9. The Commission's enforcement criteria and Enforcement Response Guidelines are available at <http://www.comcom.govt.nz/the-commission/commission-policies/>

Consumer protection is the primary purpose of the fees provisions

- 15 The Act is consumer protection legislation. This is evident in the Act where Parliament has stated that the primary purpose of the Act is to protect the interests of consumers in connection with credit contracts.¹⁰
- 16 In *Sportzone* the Supreme Court reinforced that the main objectives of the fees provisions are to:¹¹
 - protect consumers; and
 - allow for comparability between competing credit offerings.
- 17 The consumer protection purpose is important when interpreting the fees provisions – the fees provisions must be viewed in light of this purpose and interpreted in a way that best achieves this purpose.
- 18 The Act undoubtedly has additional purposes.¹² For example, since the 2015 amendments the promotion of “fair, efficient, and transparent markets for credit” is listed as a general purpose of the Act,¹³ sitting beneath the primary consumer protection purpose.
- 19 In *Sportzone*, the Supreme Court reinforced this hierarchy of purposes. The Court acknowledged that encouraging pricing flexibility and lending market efficiency were objectives of the Act, but held that these purposes are subordinate to the consumer protection and comparability purposes.¹⁴

The Lender Responsibility Principles and Responsible Lending Code

- 20 Compliance with the Principles is mandatory for lenders. The Principles require lenders to meet all of their obligations to borrowers under the Act.¹⁵ Those obligations include ensuring that all credit and default fees charged are reasonable, and that fees are disclosed in plain language in a clear, concise and intelligible manner.¹⁶
- 21 Lenders are advised to ensure that they are familiar with the contents of the Code, which provides guidance to lenders on compliance with the Principles.¹⁷ Section 10 of the Code provides advice on the fees provisions.
- 22 Compliance with the Code is not mandatory, although compliance with Part 10 of the Code is evidence of compliance with the Principles and the requirement for fees to be reasonable.¹⁸

10. Subsections 3(1) and (2)

11. *Sportzone* Supreme Court judgment at [61].

12. Section 3.

13. Section 3(2).

14. *Sportzone* Supreme Court judgment at [61].

15. Section 9C(3)(f).

16. Section 9C(3)(b)(ii).

17. <https://www.mbie.govt.nz/dmsdocument/21456-responsible-lending-code-june-2022..>

18. Section 9E(3) and 44B.

- 23 Evidence of compliance as described above is not definitive evidence as to the reasonableness of fees. Other evidence can be adduced to determine whether a lender has charged unreasonable fees. A court can look at other factors it considers relevant when determining whether a fee is reasonable.

Overview of the fees provisions

- 24 The fees provisions are of broad scope and regulate:
- What fees can be charged.
 - The costs and losses that can be recovered by way of fees.
 - How the fees must be disclosed and described.
 - The records that lenders must keep of how they have calculated fees.
- 25 The central provision (section 41) prohibits lenders from providing for unreasonable credit and default fees. This means that the loan terms must not allow a lender to charge a fee that is unreasonable.
- 26 Sections 42 to 45, 51 and 54 prescribe rules for particular types of fees. The general prohibition against unreasonable fees applies to all types of fees. These guidelines discuss each fee category in the usual order in which they are charged during the life of a loan – other than third party fees which are dealt with at the end of these guidelines:
- **Establishment fees** (section 42): see [112] to [116] below.
 - **Credit fees other than establishment and prepayment fees** (section 44): see [117] to [136] below.
 - **Prepayment fees** (sections 43, 51 and 54): see [137] to [159] below.
 - **Default fees** (section 44A): see [160] to [180] below.
 - **Third party fees** (section 45): see [181] to [194] below.
- 27 Following *Sportzone* it is now beyond doubt that credit and default fees under consumer credit contracts cannot be used to generate profits or to recover business costs that are not closely connected to the transaction between the borrower and lender. Lenders must recover their profit and any costs not allowed by the fees provisions from interest charges or charges for optional services.¹⁹

The fees provisions apply to consumer credit contracts

- 28 The fees provisions apply to consumer credit contracts entered into from 1 April 2005. They do not apply to any other kind of credit contract (for example, commercial loans).
- 29 A consumer credit contract is a contract where:²⁰
- the borrower:
 - is a natural person (in other words, they are not a company or incorporated society); and
 - the credit is used or intended to be used wholly or predominantly for personal, domestic or household purposes (as opposed to business or investment purposes);

19. *Sportzone* Supreme Court judgment at [74]. See also s 5 definition of “credit fees”, which at b(ii) excludes charges for an optional service. Such fees may only be charged where the customer has agreed to receive the optional service and to pay for it.

20. Section 11.

AND

- the lender:
 - is in the business of providing credit (such as a finance company or bank) – although lending does not have to be their only business or main business; or
 - is in the practice of providing credit as part of their business (For example, a car dealer); or
 - makes a practice of entering into credit contracts on behalf of someone else; or
 - was introduced to the borrower by a paid adviser or broker;

AND

- the contract requires the borrower to pay fees, interest or provide a security interest over consumer goods.

- 30 Some consumer credit contracts are specifically exempted from the rules.²¹ For example, unarranged overdrafts and loans under the Student Loans Scheme are not subject to the fees provisions. Pawnbroking contracts entered into under the Secondhand Dealers and Pawnbrokers Act 2004 are also not subject to the fees provisions. However, pawnbroking contracts are subject to other provisions of the Act, including the Principles, and can be reopened under the oppression provisions in Part 5 of the Act.

Examples

In 2010, Jenny and Hoani borrowed money from Bank A to purchase their family home. That loan is a consumer credit contract.

In 2015, Jenny and Hoani borrowed money from Bank B to purchase an investment property. That loan is not a consumer credit contract. The loan was for investment purposes, rather than personal, domestic or household purposes.

Vikram borrowed money from Finance Company C to purchase a van. Vikram intends to use the van primarily as a courier van, although he will also use it as a family vehicle on weekends and holidays. The loan is not a consumer credit contract, as the van is not being used wholly or predominantly for personal, domestic or household purposes.

All fees must be disclosed and accurately described

- 31 Consistent with the consumer protection purpose of the Act, before the contract is entered into, lenders must disclose in a disclosure statement all fees to be charged under the consumer credit contract.²² This disclosure must not be likely to deceive or mislead the borrower.²³ Clear disclosure is also a requirement of the Principles.²⁴

21. Section 15.

22. Section 17. There may also be applicable advertising requirements; see Regulation 4AAAS.

23. Section 32(1)(d).

24. Section 9C(3)(b)(iii).

- 32 The amount of any fee that is ascertainable at the date the contract is entered into must be disclosed. If the amount of the fee is not ascertainable the lender must set out how the fee will be determined.
- 33 The description of a fee must accurately reflect the activity to which the fee relates, and must not mislead borrowers about what the fee is for. Obscurity in fee descriptions can impede the statutory purpose of allowing consumers to readily compare credit offerings.
- 34 In relation to third party fees, while the Act does not impose an obligation on lenders to disclose these separately from fees charged for the lender's own costs, it is preferable to do so. Lenders who separately disclose third party fees are providing clearer and better information to borrowers and are less likely to breach the Fair Trading Act 1986 (**FT Act**) by misrepresenting the nature of the fee.

No business models are exempt from the fees provisions

- 35 The fees provisions apply no matter what business model or structure the lender adopts, provided that the agreement between the parties is a consumer credit contract.

What credit fees are

- 36 Credit fees are defined under the Act as fees that meet one or more of the following criteria:²⁵
- 36.1 they are payable by the borrower **under a credit contract**;
 - 36.2 they are **payable by the borrower to the lender in connection** with a credit contract; and/or
 - 36.3 they are payable by the borrower **for the benefit of the lender** in connection with a credit contract.
- 37 The definition explicitly includes establishment fees, prepayment fees, some insurance premiums and fees or charges payable to a person or company associated with the lender.
- 38 Credit fees do not include:
- interest charges;
 - charges for optional services;
 - default fees;
 - government charges, duties, taxes or levies;
 - fees or charges payable to an un-associated third party; or
 - cancellation charges under a layby sale agreement.



25. Section 5.

The credit contract might include more than one document

- 39 A credit contract may comprise multiple agreements and may include documents other than the “loan agreement” itself. Where a loan is part of an arrangement that involves multiple agreements or documents and the borrower is charged fees, lenders should seek legal advice about which documents form part of the credit contract.
- 40 The Court of Appeal in *Harmony* considered whether three documents titled “borrower agreement”, “loan contract” and “loan disclosure” taken together formed a credit contract.²⁶ The Court found that a reasonable observer would understand that the documents were “operating together” as a single contract. The Court considered the fact that the documents referred to each other, the key terms of the loan were found in the loan disclosure and that the borrower agreement was essential to the formation of a loan. The Court also considered that it did not matter if some of the documentation included information that was not part of the credit contract.

Fees added to the borrower’s loan balance are likely to be credit fees

- 41 In *Harmony*, the Court of Appeal also considered whether a fee, required under the contract and added to the loan balance, but paid to a third party for the benefit of the creditor was a credit fee.²⁷ The Court decided that a fee can be a credit fee if the borrower’s obligation to pay it is contained in a term in the credit contract and the fee is added to the balance of the loan, even if it is not paid to the creditor.²⁸
- 42 Fees that the borrower pays to the lender that are not contained in the contract and are not added to the loan balance may still be credit fees if there is a sufficient relationship or connection between the fee and the credit contract.

Fees payable by the borrower that have a direct benefit on the lender will be credit fees

- 43 If the borrower pays a fee to a third party in connection with a consumer credit contract, that fee will be a credit fee if there is a direct benefit to the lender.²⁹ To be a direct benefit, the fact that the lender has merely avoided a cost it would otherwise bear by passing it on to the borrower may not be enough.³⁰ In *Harmony* the Court said: “the fact that a creditor merely avoids a cost it would otherwise bear is too indirect and remote”.³¹

General principles that apply to the fees provisions

All credit and default fees must be reasonable

- 44 The concept of reasonableness is central to the fees provisions. All credit and default fees must be reasonable. The assessment of reasonableness is an objective one.³²

26. *Harmony*.

27. *Harmony* at [95]-[101]. This does not include third party fees.

28. *Ibid*.

29. *Harmony* at [106]-[111].

30. *Harmony* at [110].

31. *Ibid*.

32. *Sportzone* Supreme Court judgment at [39].

Fees are restricted, but interest is not

- 45 As recognised in *Sportzone*, the fees provisions are “intended to place a real constraint on what lenders are entitled to charge by way of fees.”³³ Fees cannot generate profit for the lender or recover more than the costs permitted by the Act.
- 46 The restriction on credit and default fees does not limit the revenue a lender can earn under a consumer credit contract. There are no limitations on the interest charges that a lender can impose, provided that the interest is:³⁴
- disclosed to the borrower; and
 - not set at an oppressively high level.³⁵

Costs and losses are key in assessing reasonableness

- 47 The lender’s own costs and losses, where applicable, are the key factors in deciding whether a lender’s credit and default fees are reasonable.
- 48 In *Sportzone* the Supreme Court said that, while cost is not the sole determinant of reasonableness, there is not much scope for “non-cost based factors” to be used in establishing reasonableness:³⁶
- ... we do not think Parliament contemplated the possibility that a Court would be able to conclude that factors other than cost could outweigh cost in the determination of the reasonableness of fees.
- 49 For example, in *Sportzone* the Court said that the fees charged by competitors are unlikely to materially assist a lender to establish reasonableness.³⁷
- 50 In *Commerce Commission v Avanti Finance Ltd* the High Court,³⁸ when assessing the losses recoverable under a prepayment fee, concluded that a lender could only recover the actual losses it expected to sustain in the event of prepayment.³⁹ This expected-loss approach will apply equally to default fees – the other fee type under which losses can be recovered.

Lenders must apply a transaction-specific approach to recovering costs

- 51 The costs that a lender seeks to recover must be transaction-specific – there must be a close connection between the cost and the transaction in respect of which the fee is charged. Credit and default fees that seek to recover costs that are not transaction-specific are likely to be unreasonable.
- 52 The High Court and Court of Appeal in *Sportzone* expressed a ‘close relevance test’ to determine whether fees were reasonable. Under that test, the cost that a lender seeks to recover must be sufficiently close and relevant to the establishment, administration or maintenance of

33. *Sportzone* Supreme Court judgment at [39].

34. With the exception that if the loan is a high-cost consumer credit contract, interest and fees must be capped at 100% of the amount first advanced (see section 45E).

35. See s 120 of the Act and our Fact Sheet on Oppression at https://comcom.govt.nz/__data/assets/pdf_file/0033/89655/Oppressive-contracts-Fact-sheet-July-2018.pdf. Note that the Act contains a number of restrictions on how and when interest can be charged under a contract, including the need for annual interest rates to be specified; a prohibition against requiring interest to be paid before it becomes due; and limitations on the calculation of interest charges and default interest charges.

36. *Sportzone* Supreme Court judgment at [92], [94].

37. *Sportzone* Supreme Court judgment at [94].

38. *Commerce Commission v Avanti Finance Limited* (2009) 9 NZBLC 102,662 (HC) (*Avanti Finance*).

39. *Ibid* at [31].

the particular loan, or to the consequences of the particular borrower's default, that it can reasonably be said that the cost was incurred in connection with the loan.

- 53 The Supreme Court held that a transaction-specific approach needs to be taken when setting credit and default fees,⁴⁰ and that fees should not be set at a greater level than is needed to recover the transaction-specific costs incurred by the lender.⁴¹
- 54 The Supreme Court recognised that, in applying the transaction-specific approach, the close relevance test adopted by the High Court and Court of Appeal was a helpful formulation in determining the reasonableness of the fee.⁴²
- 55 The Supreme Court was also clear that general overheads that are not transaction-specific should not be recovered,⁴³ and that credit and default fees are not a means of recovering all operating costs:⁴⁴

It is not permissible to take all operating costs (or virtually all) and allocate them to one fee or another. The consequence of this is that many costs incurred by a credit provider will not be referable to particular credit transactions and will therefore have to be recovered in the interest rate.

- 56 The Supreme Court also stated that costs recovered through credit and default fees must relate to the transaction with the particular borrower. The Court noted that the drafting language used in section 42 of the Act deploys the definite article: the costs of *the* application for credit, processing and considering *that* application, documenting *the* contract and advancing *the* credit.⁴⁵ The use of the definite article indicates a statutory emphasis on specific transactions:

This [drafting] cannot sensibly be seen as referring to acts and omissions of debtors generally or even debtors of a particular class. Rather, it focusses on the individual debtor on whom the fee is levied.

- 57 Further, the Supreme Court stated that a fee cannot be justified on the basis that there may be a beneficial relationship between a cost and the activity for which the fee is charged. The cost must relate to the specific transaction, not some loose concept of a beneficial connection.⁴⁶
- 58 Accordingly, the Supreme Court found that the *Sportzone* lenders had adopted an unlawful approach in allocating virtually all of their operational costs to fees. Costs that were disallowed due to the absence of a close connection included treasury costs, the costs of capital and provisions for bad debt.⁴⁷



40. *Sportzone* Supreme Court judgment at [111].

41. *Sportzone* Supreme Court judgment at [113].

42. *Ibid.*

43. *Ibid.*

44. *Sportzone* Supreme Court judgment at [111].

45. *Sportzone* Supreme Court judgment at [68].

46. *Sportzone* Supreme Court judgment at [80]-[82].

47. *Sportzone* High Court quantum judgment at [69], [94] and [115].

Examples

Lender D charges a credit fee to customers to recover the cost of its general advertising and promotion. This fee is unreasonable because the costs incurred have no close relationship to the specific transaction between the lender and borrower.

As part of its Loan Administration Fee, Lender E seeks to recover the cost of its annual Christmas party. This fee is unreasonable as the costs of the Christmas Party have no close relationship to the specific transaction between the lender and borrower.

- 59 The Code expresses the test in the following way:

Lenders should ensure that costs recovered relate to the specific credit contract or that class of credit contract. Costs should be sufficiently close and relevant to the steps in the lending process to which the fee relates that they can reasonably be said to be incurred in relation to those steps.

Lender may average its costs for appropriate classes of contract

- 60 The Act expressly allows a lender to charge an establishment fee that is equal to or less than the lender's average reasonable establishment costs for the appropriate class of contract.⁴⁸ Although the matter has not yet been considered by the courts, the Commission considers that it is also reasonable for a lender to average its costs for appropriate classes of contract when setting other cost-based fees.
- 61 An "appropriate class" of credit contract will be a group of contracts that are so similar in nature that they are likely to attract the same type and level of costs.
- 62 Where a lender uses materially different procedures or takes materially different steps for its contracts depending on the type of loan, and those different procedures and steps are likely to result in different costs, the lender should treat these contracts as being of different "classes". The fees charged for each class of contract should only be those that are reasonable for that class.

Example

Lender F offers both secured and unsecured loans. It costs more to establish a secured loan, due to higher documentation and security registration costs. In setting an establishment fee, Lender F should not combine average costs for secured loans and unsecured loans to set a single uniform establishment fee. The establishment fee for each class of loan should be set and charged separately.

Lender G requires a guarantee for high risk borrowers. It costs more to establish a guaranteed loan, due to higher documentation costs and the cost of ensuring that the guarantor has been provided with all relevant information. In setting an establishment fee, Lender G should not charge a uniform fee for guaranteed and non-guaranteed loans. The establishment fee for each class of loan should be set and charged separately.

48. Section 42(b).

- 63 A lender should take reasonable steps to ensure that the costs it seeks to recover from the loans of a particular class will in fact be incurred in relation to the loans of that class. If a lender seeks to recover a cost that has not been incurred, the fee is likely to be unreasonable.
- 64 Consequently a lender might have several different fees for the same activity – ie, several different establishment fees reflecting the reasonable costs applicable to establishing different classes of loan.

A lender may estimate its costs

- 65 The amount of a fee, or the method by which the fee will be calculated, must be disclosed before a loan contract is entered into. This means that lenders often set their fees in advance of incurring the cost. Necessarily, this means a lender must estimate what their costs are likely to be in order to comply with the obligation to disclose the amount of the fee.

Method of estimating costs

- 66 Any estimation should involve a prediction of the costs (for example, the cost of time likely to be spent on the relevant activity) that will be incurred in connection with either the specific loan or with all expected loans falling within that class. When estimating the cost of a class of loans, the total estimated cost should be divided by the expected number of transactions (ie the number of loans or the number of cost driving events). For example, total estimated default costs for a particular class of loans should be divided by the number of payment defaults estimated for those loans to estimate the cost per default fee.
- 67 The Code provides useful guidance on the approach that a lender should take to setting credit fees in advance:⁴⁹
 - 67.1 Lenders should assess the costs that are likely to be incurred in relation to the matter giving rise to the fee. The assessment should take into account past experience (if any) of the level of costs incurred for those activities for the same or similar credit products, but apply that experience on a forward-looking basis to estimate the likely future costs per loan or class of loans.
 - 67.2 Lenders should ensure that each credit fee only seeks to compensate for those likely costs.
- 68 *Sportzone* also provides guidance for lenders, to ensure that this estimation is as accurate as it can be. The Supreme Court said that “where averaging is permitted, this should be done for a representative sample of transactions so that the average cost per transaction can be assessed.”⁵⁰
- 69 For a new lender that has no past cost data on which to rely, the fee setting process will require a greater degree of estimation as to the level of transaction-specific costs. The lender should carefully estimate its likely transaction-specific costs and the likely number of transactions across which those costs can be charged.

49. Responsible Lending Code at [10.3].

50. *Sportzone* Supreme Court judgment at [73].

Example

New Loans R Us, a new lending business, estimates that it will establish 100 new loans in its first year. Using cost accounting allocation methods, it expects its establishment related costs to be \$7,500. On that basis, an establishment fee of \$75 per loan is likely to be reasonable.

- 70 The Commission considers that the Act does not require exact precision for fees that are estimated in advance – instead the lender is required to make reasonable efforts to ensure that the estimated fee is as accurate as possible. Where a lender sets its fees in advance by apportioning costs using a documented, consistent, robust and reasoned approach referencing generally accepted principles of activity-based cost accounting, its approach is likely to be reasonable.

Fees should be regularly reviewed

- 71 From 1 December 2021, all lenders must keep credit and default fees regularly under review so that they can ensure the fees they are charging only recover transaction-specific costs and losses and are not unreasonable.⁵¹ Lenders must also keep records about how they have calculated their fees;⁵² those calculations must demonstrate that each fee was not unreasonable at the time it was calculated/reviewed.⁵³ The records must be kept for a period of at least seven years after the date on which the fee was calculated or reviewed.⁵⁴ Lenders must make their fees records available within 20 working days:
- 71.1 to the Commission, on request by the Commission;⁵⁵ and
 - 71.2 to a dispute resolution scheme, if requested by that scheme and in relation to a dispute under that scheme.⁵⁶
- 72 Also from 1 December 2021, the Act requires lenders to review credit and default fees when they know, or ought reasonably to know, that there has been a change to their business and/or costs that is likely to materially affect their fees.⁵⁷ For example, lenders must review their fees whenever they are on notice that their forecasted costs and/or estimated transaction numbers differ materially from their actuals.⁵⁸ In addition, we recommend that lenders regularly review their fees against their costs, for example annually.
- 73 Lenders must reduce their credit and default fees if, following their review, the fees are determined to be unreasonable.⁵⁹ Lenders could be subject to a penalty if they fail to undertake a review in these circumstances and/or to reduce any fees that are determined to be unreasonable after that review.

51. Section 41A(3) and Responsible Lending Code at [10.12].

52. Section 41A(1); refer to [77]-[80] below for more information.

53. Section 41A(2).

54. Section 41A(8).

55. Section 41A(4) and (6). The Commission may specify a longer period of time to provide the requested fees records.

56. Section 41A(5) and (6).

57. Section 41A(3)(a).

58. Section 41A(3) and Responsible Lending Code at [10.12].

59. Section 41A(3)(b).

Example

Halfway through its first year of lending, New Loans R Us realises that its assumptions of establishing 100 loans in the first year are on-track, but that it costs less to establish the loans than it had anticipated. On average, it costs \$50 to establish each loan. New Loans R Us should reduce its establishment fee from \$75 to \$50 to ensure that it is not unreasonable.

- 74 Depending on the circumstances, a review does not need to be a full cost accounting exercise. The review may simply involve a high level assessment – for example, checking that fee revenue for a particular activity does not exceed the total of the cost centres related to that activity. A fuller review may be required where it becomes apparent that fee revenue is exceeding costs, if the lender is to meet the reasonableness requirement.
- 75 The Commission is clear in its Enforcement Response Guidelines that compensation to affected consumers is an important consideration in our decisions about enforcement outcomes.⁶⁰ If, following a review, the lender becomes aware that it has been charging a higher fee than it was entitled to charge, the Commission considers the lender should reduce its fee and refund those borrowers who have been overcharged. Although there is no requirement to refund, the borrower is entitled to seek a refund through the courts or to complain to the Commission, which can act on the borrower's behalf.
- 76 If borrowers are promptly compensated upon the lender discovering its error, the Commission will take that into account when deciding whether or not to take enforcement action.

Demonstrating reasonableness

- 77 The records that lenders are required to keep from 1 December 2021 must demonstrate that each credit and default fee was not unreasonable at the time it was calculated or reviewed.⁶¹
- 78 In order to demonstrate that the fee was not unreasonable at the time it was calculated or reviewed, the Commission expects that a lender's records should:
 - 78.1 Identify any closely related costs associated with the matter giving rise to the fee and explain the connection. For example, salary costs associated with staff who are responsible for considering new loan applications will likely be recoverable under an establishment fee.
 - 78.2 Provide the basis for determining the total **amount** of the closely related costs, including information that the lender has used to make any forward-looking estimates. For example, if the lender seeks to recover premises costs via an establishment fee, it should take into account its prior actual premises costs and make any necessary adjustments for predicted changes in the amount (ie, if it is known that there will be a reduction in the future cost as a consequence of moving to a smaller premises). Any deviation from estimates will necessarily impact the calculated fee amount, therefore estimates should be reassessed, and if necessary adjusted, during the period in which the fee is charged.

60. <http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/>.

61. Section 41A(2).

- 78.3 Identify the **recoverable proportion** of any closely related costs and set out how that proportion has been calculated. For example, staff involved with considering new loan applications will likely spend a portion of their time assessing unsuccessful applications, as well as on other activities which are not related to loan establishment (eg, in team meetings, in training and/or performing activities giving rise to another fee), meaning that not all of their time is recoverable via an establishment fee. The total cost recovered across all fees should not exceed 100% for any cost category (eg, salaries) and/or individual.
- 78.4 Document the anticipated **number of transactions** which the costs are expected to be incurred in connection with. For example, in the case of establishment costs, the estimated number of new loan applications; in the case of default costs, the estimated number of payment defaults.
- 78.5 Set out any **assumptions** on which the fee calculations are based (for example, a forecast of the number of loans the lender anticipates entering into) and provide the basis for those assumptions. For example, the lender entered into 10,000 loans in the last financial year and, on the basis of historical data and taking into account current information (including investment into advertising or promotional activities, development of new product offerings, etc.), is forecasting growth of 3% this year.
- 78.6 For default fees, identify and quantify any **estimate of loss** arising from the acts or omissions of the borrower that the lender wishes to consider in setting the fee.
- 79 Where different fees are charged for different loan classes, the lender should hold records that demonstrate the reasonableness of the costs for each loan class respectively.
- 80 Lenders can be liable for pecuniary penalties if they do not keep records, and also if those records do not demonstrate that the credit or default fee is reasonable.⁶²
- 81 Due diligence obligations also mean that directors and senior managers will need to have taken reasonable steps to ensure that the lender has systems and processes in place to ensure that it is not charging unreasonable credit and default fees.⁶³

The activities conducted must be reasonable

- 82 It must also be reasonable to incur the costs. That is, the activity must be reasonable in relation to the loan, or class of loans, it is being charged to. For example, if a lender charges a range of administration fees based on differing levels of risk, it must be reasonable to incur additional costs in relation to administering those higher risk loans.⁶⁴

The activities must actually occur

- 83 The activity itself must also occur if it is to be included. In setting credit and default fees, it is not permissible to take into account the cost of an activity that the lender may or may not undertake. For example, in setting a default fee, a lender should not take into account an estimate of costs associated with preparing and sending a pre-possession notice unless the lender actually sends a pre-possession notice to all borrowers charged that default fee.

62. Section 107A(1)(a)(iii) and (iv).

63. See the Commission's Due Diligence guidance at <https://comcom.govt.nz/business/your-responsibilities-if-you-provide-credit/due-diligence-guidance>.

64. Responsible Lending Code at [10.3(d)].

- 84 The Commission took proceedings against a lender for charging a late payment fee to borrowers that had not made payment within seven days of the due date. In setting that fee, the lender took into account costs associated with steps that it took in relation to borrowers who were still in default after 14 days. The lender accepted that the default fees were unreasonable in that they recovered costs that might not be incurred in respect of all borrowers.⁶⁵

Costs must actually be incurred

- 85 The Commission occasionally sees lenders charging credit and default fees to recover costs that are not in fact incurred. For example, we have prosecuted a lender for breaching section 41 by charging a security registration fee where the lender did not proceed to register a security.⁶⁶ Such fees are unreasonable, and may also falsely represent that the lender has undertaken an action that it did not, which is likely to breach the FT Act.

Fee must be charged at or around the time the cost or loss is incurred

- 86 Although the Act requires lenders to disclose credit and default fees in advance of charging them, and to estimate costs for this purpose, lenders should ensure that the customer pays the fees only at or around the time of the lender incurring the cost or loss. If fees are ‘front-loaded’ onto a customer’s account, the customer will typically pay more interest on their loan balance. Lenders should charge for steps in the loan process at or around the time that they incur the costs or losses. For example, establishment costs can only be charged to the customer at the time of establishing the loan.

Charging a fee at all may be unreasonable

- 87 In *Sportzone* the Supreme Court recognised the possibility that some fees should not be charged at all, regardless of their level.⁶⁷

In the present appeal, the focus was on the *level* of the fees charged by Sportzone/ MTF, rather than on the reasonableness of charging any fee. On the face of it, the charging of a fee that could not be justified at all would also fall foul of s 41. The section appears to cover both whether the charging of any fee at all is reasonable as well as whether the level of the fee is reasonable.

- 88 Accordingly, some fees may be unreasonable even where they do no more than recover the lender’s actual costs.

Example

A lender prosecuted by the Commission was charging a “Welcome letter fee” to borrowers. The welcome letter was sent to customers to introduce the lender to the customer – it did not contain information that was required to be disclosed. The fee for the letter was \$15. This fee was likely to be unreasonable, even if the cost of sending the letter was \$15, because “welcoming” the borrower was not a step for which it was reasonable to charge a fee.⁶⁸

65. <https://comcom.govt.nz/news-and-media/media-releases/2021/udc-settlement-with-commission-on-unreasonable-fees>.

66. *Commerce Commission v Ace Marketing Limited* [2016] NZDC 19165.

67. *Sportzone* Supreme Court judgment at [26].

68. *Commerce Commission v Budget Loans Limited* (DC AK, CRI-2009-004-0238349, 26 July 2010). The prosecution was brought under the FT Act, but could be brought on similar facts under the Act.

Not all actual costs are reasonable

- 89 Where it is reasonable to charge a fee, we are unlikely to consider the level of the fee to be reasonable if it includes costs that, while actually incurred, are unusually high or relate to a step unreasonably taken.⁶⁹
- 90 Costs may be unreasonably high where:
- they are significantly above the commercial norm;
 - the lender adopts a business practice or structure that unnecessarily raises the costs it seeks to recover through fees; or
 - the lender fails to adopt cost saving practices, technologies and structures where it is reasonable to do so.

Deterrent fees may be unreasonable

- 91 A fee that is set to deter or discourage a borrower from certain conduct must, as with other fees, not be unreasonable.
- 92 When determining whether a deterrent fee is unreasonable, the court must have regard to whether it reasonably compensates the lender for the costs it incurred, including the costs of providing a service.⁷⁰
- 93 In determining whether the deterrent fee reasonably compensates, the Court must have regard to reasonable standards of commercial practice.⁷¹ As below, just because a commercial practice is common does not make it reasonable.

Example

Lender E charges a late payment fee of \$20 for overdue credit card payments. The transaction-specific costs and losses arising from late payment are \$5. Lender E justifies the remainder of the fee on the basis that it is necessary to deter borrowers from missing credit card payments. This fee is unreasonable.



69. This is consistent with the reference in ss 44 and 44A to “reasonable standards of commercial practice” and to s 3(2)(b) of the Act which relates to the purpose of the Act in promoting efficient credit markets.

70. Section 44(1).

71. Section 44(2).

Consistency with a competitor's fees will not make a fee reasonable

- 94 It is common for lenders to attempt to justify a fee on the basis that the fee is consistent with what other lenders are charging in the market. For credit fees other than establishment and prepayment fees (see [122] to [159] below), fees charged by other lenders might assist a lender in assessing whether its fees are in line with “reasonable standards of commercial practice.”⁷²
- 95 However, caution is required when lenders seek to rely on the fees that others are charging in the market when setting their own fees. We acknowledge that this comparison can be a useful way for a lender to ‘sense-check’ the fees that it proposes charging. Such a comparison may reveal that the lender is proposing to charge a fee that is higher than those seen commonly in the market – which can signal that the lender’s proposed charges are out of line with those of comparable lenders, and may indicate that it proposes charging non-compliant fees.
- 96 However, the lender’s own costs are the critical consideration. The reasonableness of a fee depends on the lender’s own costs and losses – and comparisons against the level of other lenders’ fees cannot provide such information.
- 97 The courts have also cautioned against lenders placing undue weight on the level of a competitor’s fees in setting their own fees. The Supreme Court noted in *Sportzone* that competitors’ fees may be a relevant consideration where the competitors’ fees are themselves reasonable. However, the Court noted that:⁷³

... the proposition that similarity with competitors indicates reasonableness cannot be accepted at face value, because it does not take into account the relationship between the costs of the competitors and the fees they charge. Nor can it be assumed that competitors’ practices are, themselves, reasonable commercial practice.

Percentage-based fees

- 98 The Commission is aware of lenders who charge percentage-based fees; for example, an establishment fee of 10% of the principal being borrowed.
- 99 Percentage-based fees run a high risk of being unreasonable. It is difficult to see how a lender could demonstrate in advance that a percentage-based fee would accurately recover only the allowable costs in all cases. 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.

Costs and losses that are recoverable through fees

- 100 As discussed above, the Supreme Court has recognised that lenders can recover the transaction-specific costs and losses of the activities relevant to each fee.⁷⁴
- 101 Each cost proposed to be recovered through a fee needs to be assessed in the circumstances of the lender’s business. The primary question is always whether a cost is incurred in relation to the steps to which the fee relates. Costs which cannot be clearly shown to be transaction-specific, although they may have a beneficial relationship to an activity, should not be included in the calculation of a reasonable fee.

72. Section 44(2).

73. *Sportzone* Supreme Court judgment at [93].

74. *Sportzone* Supreme Court judgment at [73].

Recovering fixed and variable costs

- 102 The Supreme Court, like the courts below it, considered whether the fixed and variable costs of the *Sportzone* lenders could be recovered. The Court did not appear to find the distinction between fixed and variable costs to be of great assistance, noting that the exercise is simply one of applying the Act to the costs that have been claimed.⁷⁵
- 103 Nonetheless, these accounting concepts are of some use in assisting lenders to understand how the fees provisions are likely to apply to different types of costs.

Fixed costs

- 104 **Fixed costs** are the costs of a business that do not change as a result of the number of loans that a lender enters into.
- 105 Fixed or general costs incurred in the lender's business that are not transaction-specific are generally not recoverable in credit and default fees,⁷⁶ but can be recovered in the interest rate.
- 106 The High Court in *Sportzone* found, in the context of the facts before it, that some fixed costs were recoverable through fees where those costs are sufficiently closely connected to the steps taken in the particular loan transaction, (Such that the costs could be considered to be transaction-specific and therefore recoverable).
- 107 We provide guidance in the tables below about the types of fixed costs that may or may not be recoverable within fees.

Variable costs

- 108 **Variable costs** are those costs that vary depending on the number of loans a lender enters into. Variable costs can include the direct material costs and direct labour costs that are necessary to perform the transaction between the borrower and lender. For example, costs associated with credit checks are commonly incurred by lenders on a per transaction, and therefore variable, basis.
- 109 A fee that recovers no more than the variable costs of the particular transaction is likely to be reasonable.
- 110 In *Sportzone*, the Supreme Court said:⁷⁷
- ... a fee based on the variable costs incurred in taking the steps for which the fee is charged is likely to be at, or below, the level that would be considered "reasonable" for the purposes of s 41 of the 2003 Act, assuming the costs themselves are reasonable.

Losses

- 111 A lender can charge a fee where it suffers loss as a direct consequence of the prepayment of a loan or when a borrower defaults. We provide further guidance below on the approach lenders should take when setting these fees.

75. *Sportzone* Supreme Court judgment at [82].

76. *Sportzone* Supreme Court judgment at [113].

77. *Sportzone* Supreme Court judgment at [114].

Establishment Fees

- 112** An **establishment fee** is a fee or charge to a borrower that relates to costs incurred by the lender in connection with:⁷⁸
- The application for credit.
 - Processing and considering an application.
 - Documenting a loan contract.
 - Advancing credit to a borrower.
- 113** These are the only costs that can be recovered through an establishment fee. Where costs are not connected to the four listed activities, they must be recovered through the interest rate or through another suitable credit fee.
- 114** The prescribed test for determining the reasonableness of an establishment fee provides that:⁷⁹
- 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 creditor'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 creditor's average reasonable costs of the matters referred to in paragraph (a) for the appropriate class of consumer credit contract.
- 115** The Code provides useful guidance about how lenders should approach the task of setting establishment fees.⁸⁰ It suggests that one of the lender's first tasks should be to:
- Identify the tasks undertaken in order to establish the credit contract or that class of consumer credit contract and calculate the costs of undertaking each of those tasks.

Costs that can be recovered through an establishment fee

- 116** Costs commonly thought to be recoverable through establishment fees are identified below, together with our assessment as to whether they can be lawfully recovered.

TABLE 1: Establishment fees

Cost	Can this cost be recovered within establishment fees?
Staff costs	An appropriate apportionment of the wages, salaries, performance schemes and ancillary costs of staff may be charged for those staff involved in establishing a particular loan or class of loans. ⁸¹ Costs of training staff are not recoverable.

78. Section 5.

79. Section 42. Note that the charging of an establishment fee is limited to the reasonable costs of the listed functions (application for credit, processing and considering that application, documenting and advancing the credit), regardless of who performs these functions.

80. Responsible Lending Code at [10.1].

81. In the table, "establishing a loan" refers to the processes described in s 42 of the Act, i.e. applying for the credit, processing and considering that application, documenting the credit and advancing the credit.

Depreciation	If the depreciation cost relates to assets used in close connection with establishing a particular loan or class of loans, an appropriate apportionment of the depreciation cost may be charged for assets used. ⁸² The lender cannot claim depreciation on assets where the cost of those assets has already been recovered by other fees or some other means, or on assets that are not used in close connection with the establishment of the particular loan or class of loans.
Costs related to debt recovery	No. These are not costs in connection with establishing a loan. The costs of a particular borrower's default arise only once the borrower is in default. This can be recovered as a default fee.
Administration costs	If administration costs not otherwise mentioned in this table are incurred in close connection with establishing a particular loan or class of loans, an appropriate apportionment of those costs may be charged. For example, postage fees for mailing initial disclosure documentation are closely connected to establishment of the loan and therefore an appropriate portion of these costs may be recovered. Establishment fees should not be used to recover overheads that are not closely connected to the establishment of the loan, because these will not be transaction-specific.
Premises costs	If the lender can establish a sufficiently close connection between the premises costs and establishing a particular loan or class of loans, an appropriate apportionment of premises costs may be charged.
IT costs	If the lender can establish a sufficiently close connection between the IT costs and establishing a particular loan or class of loans, an appropriate apportionment of the IT costs can be charged.
Marketing and advertising costs	No. These are not the costs of loan establishment activities, but rather are usually intended to maintain or grow the lender's business.
Bad debt write-off ⁸³	No. These are not the costs of loan establishment activities. ⁸⁴
Provision for doubtful debts	No. These are not the costs of loan establishment activities.
Head office costs	If the lender can establish a sufficiently close connection between the head office costs and establishing a particular loan or class of loans, an appropriate apportionment of the head office costs can be charged.
Cost of capital/treasury costs	No. Cost of capital and treasury costs must be recovered through interest; they cannot be recovered through fees.
Profit/return on capital	No. Profit and return on capital must be generated through interest, they cannot be recovered through fees. ⁸⁵

82. *Sportzone* High Court Liability judgment at [92].

83. Bad debt write-off in this context refers to the practice of bundling bad debts and attempting to recover the costs incurred across a class of consumer credit contract, rather than any costs arising from pursuing recovery from an individual defaulting borrower.

84. *Sportzone* Supreme Court judgment at [96]-[98].

85. *Sportzone* Supreme Court judgment at [100] and [106]-[107].

Declined loan applications	No. ⁸⁶ The cost of declined loans is not a transaction-specific cost of approved credit contracts. Establishment fees must only recover the cost of the particular borrower's loan establishment; a declined loan application does not result in a credit contract, and its costs cannot be attributed to another credit contract.
Entertainment costs	No. These are not the costs of loan establishment activities.
Costs relating to lenders' funding arrangements and operating structure	No. These are not the costs of loan establishment activities.

Credit fees other than establishment and prepayment fees

- 117 Fees that do not fall within the specified categories of establishment fees, prepayment fees, default fees and third party fees are referred to in the Act as **other credit fees**.
- 118 The Act does not constrain the types of other credit fees that a lender may include in a credit contract, except that all such fees must be reasonable and must relate to a matter undertaken in respect of a particular loan.⁸⁷

How is reasonableness assessed?

- 119 The Act provides two considerations for determining the reasonableness of other credit fees:
- 44(1) [Reasonable compensation]** In determining whether a credit 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 creditor for any cost incurred by the creditor (including the cost of providing a service to the debtor if the fee relates to the provision of a service).
- 44(2) [Commercial practice]** In determining whether the fee reasonably compensates the creditor for any cost referred to in subsection (1), the court must have regard to reasonable standards of commercial practice.

Meaning of “the matter giving rise to the fee”

- 120 Section 44 of the Act allows a lender to recover reasonable compensation for the costs incurred in relation to “the matter giving rise to the fee”. The “matter giving rise to the fee” means the transaction-specific activity to which the credit fee relates.

Example

Lender I charges a \$2 paper statement fee when borrowers request a paper copy of their account statement. The matter giving rise to the fee is providing this paper statement. The lender can recover the costs that are specific to receiving the request from the customer, generating the statement and sending it to the customer.

86. In *Commerce Commission v Galistair Enterprises Ltd* 6/12/07, Judge Aitken, DC Auckland CRI-2007-004-4009, the Commission successfully prosecuted a lender that included the cost of declines in its establishment fee. The Court held that this was improper and resulted in a fee that exceeded reasonable costs or average reasonable costs.

87. Section 44(1).

Meaning of “reasonably compensates”

- 121 A section 44 fee must do no more than “reasonably compensate” the lender for “any cost incurred by the lender in relation to the matter giving rise to the fee”.
- 122 A credit fee should recover only the reasonable cost of the loan-related activity, and must not include any allowance for profit or the recovery of any cost not closely related to the activity for which the fee is charged.

Reasonable standards of commercial practice

- 123 Section 44(2) requires the Commission or the court to have regard to “reasonable standards of commercial practice” in considering whether a credit fee reasonably compensates the lender.
- 124 The commercial practice assessment is not a stand-alone or alternative basis on which a lender can justify the reasonableness of a credit fee. When the 2015 amendments to the Act were considered in 2013, the Select Committee emphasised:⁸⁸

...the reasonable standard consideration should be subordinate to the principle that credit fees and default fees should only reasonably compensate the lender. Our amendment confirms and makes it clear that reasonable standards of commercial practice are not intended as a separate basis for calculating credit or default fees, but only to inform the main test (which concerns costs and losses).

- 125 A comparison of commercial practices alone cannot resolve whether a fee is reasonable. The level of fees charged by other providers can be relevant to reasonableness, where the fees charged by others are set at a reasonable level.⁸⁹ But because a costs-analysis is necessary to determine reasonableness, a fee-comparison alone is not decisive. The comparison fees may have been set by lenders who face very different costs.

- 126 The Code summarises the point:⁹⁰

... a common commercial practice is not necessarily a reasonable standard of commercial practice.

- 127 In *Sportzone*, MTF argued that its fees were not out of step with those of its competitors and must therefore be reasonable. The Supreme Court rejected this:⁹¹

... given the focus on costs in ss 42 and 44, the proposition that similarity with competitors indicates reasonableness cannot be accepted at face value, because it does not take into account the relationship between the costs of the competitors and the fees they charge. Nor can it be assumed that competitors’ practices are, themselves, reasonable commercial practice....

To conclude, we accept cost is not the sole determinant of reasonableness. But... we do not see much scope for finding that fees that are calculated to recover costs not associated with the activities for which the fee is charged being found to be reasonable because of some non-cost-based factor. MTF has not identified any such factor here. We do not see competitors’ fee levels as materially assisting its case.

88. Credit Contracts and Financial Services Law Reform Bill 2013 (104-2) (Select Committee report) at 9 (discussing cls 24-26).

89. *Sportzone* Supreme Court judgment at [92].

90. Responsible Lending Code at [10.3(d)].

91. *Sportzone* Supreme Court judgment at [93]-[94].

Insurance premium credit fees

- 128 Insurance premiums for credit related insurance, where the lender requires the borrower to obtain insurance from a particular insurer or insurers, are credit fees and must be reasonable.⁹²
- 129 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.⁹³
- 130 In 2017 the Commission prosecuted Acute Finance Limited for charging unreasonable credit fees relating to compulsory repayment waivers. Acute Finance accepted that it had charged more than its closely-related costs for the repayment waivers (which included the expected cost of claims and administration).⁹⁴

Charges for optional services are not credit fees

- 131 Charges for optional services are not credit fees.⁹⁵

What is a charge for an optional service?

- 132 A charge for an **optional service** is a fee or charge for a service or benefit that the borrower does not have to accept as a condition of entering into the contract.⁹⁶
- 133 Such services are likely to include services that do not relate to the provision of credit, and services that are genuinely additional in that they are not a functionality or use that is integrated into the credit offering.
- 134 Common examples of optional services include:
- Optional payment protection insurance, where a borrower can choose to insure or not.
 - Optional extended warranties, where a borrower can choose to purchase an extended warranty or not.
 - Functionality that the borrower applies to add on to a credit product.

Example

Hinerau borrows money to buy a car. She elects to purchase optional payment protection insurance and an extended mechanical warranty, the costs of which are added to the outstanding balance and charged as fees. The insurance and warranty are optional services. Hinerau has chosen to purchase them but could have entered into the loan without doing so.

92. Section 5 definition of “credit fee”.

93. Responsible Lending Code at [10.4].

94. [https://comcom.govt.nz/news-and-media/media-releases/2017/finance-company-fined-\\$22,000-and-returns-\\$10,000-to-borrowers](https://comcom.govt.nz/news-and-media/media-releases/2017/finance-company-fined-$22,000-and-returns-$10,000-to-borrowers).

95. Section 5 definition of “credit fee”.

96. See the definition of “charge for an optional service” at s 5 of the Act.

- 135 A service or benefit that is included in the terms of a loan is not an optional service just because the borrower can subsequently choose whether or not to take advantage of that service or benefit. If the service or benefit forms part of the loan offering and cannot be severed from the terms of the loan, the service or benefit is not an optional service.

Example

Lender J offers a credit card with the ability to withdraw funds from an overseas automatic teller machine, with fees applying to such withdrawals. The credit card contract cannot be entered into without this integrated functionality. While customers do not have to use the service, the overseas withdrawal service is not optional and the fee charged is a credit fee.

Pre-selected or undisclosed services are not optional

- 136 If the borrower is not aware that they have agreed to acquire a service, the service provided is not optional and any fee charged is a credit fee. Further, if the service has been pre-selected or pre-ticked in the contract, in our view it is not optional, as the borrower has taken no positive step to opt into the provision of the service. The lender also risks breaching the FT Act by misleading the borrower that they are purchasing one service when in fact they are purchasing a bundle of services.

TABLE 2: Other credit fees

Cost	Can this cost be recovered within other credit fees?
Staff costs	An appropriate apportionment of the wages, salaries, performance schemes and ancillary costs of staff may be charged for those staff involved in the credit fee activity. Costs of training staff are not recoverable.
Depreciation	If the depreciation cost relates to assets used in relation to the matter giving rise to the fee, an appropriate apportionment of the depreciation cost may be charged for assets used. The lender cannot claim depreciation on assets where the cost of those assets has already been recovered by other fees or some other means, nor on assets that are not used in close connection with the credit fee activity of the particular loan or class of loans.
Costs related to debt recovery	No. The costs of a particular borrower's default arise only on default, and must be recovered under a default fee.
Administration costs	If administration costs, not otherwise mentioned in this table, are incurred in close connection with the credit fee activity for a particular loan or class of loans, an appropriate apportionment of those costs may be charged. Credit fees should not be used to recover overheads that are not transaction-specific.
Premises costs	If the lender can establish a sufficiently close connection between the premises costs and the credit fee activity, an appropriate apportionment of premises costs may be charged.

IT costs	If the lender can establish a sufficiently close connection between the IT costs and the credit fee activity, an appropriate apportionment of the IT costs can be charged.
Marketing and advertising costs	No. Generic advertising costs are not transaction-specific, but rather are usually intended to maintain or grow the lender's business.
Bad debt write off ⁹⁷	No. These costs are not incurred because of the transaction between the borrower and lender.
Provision for doubtful debts	No. These costs are not incurred because of the transaction between the borrower and lender.
Head office costs	If the lender can establish a sufficiently close connection between the head office costs and the matter giving rise to the fee in the particular transaction, an appropriate apportionment of the head office costs can be charged.
Cost of capital/treasury costs	No. Cost of capital and treasury costs must be recovered through interest; they cannot be recovered through fees.
Profit/Return on capital	No. Profit and return on capital must be generated through interest; they cannot be recovered through fees.
Declined loan applications	No. The cost of declined loans is not a transaction-specific cost of approved credit contracts.
Entertainment costs	No. These costs do not relate to a particular loan.
Costs relating to lender's funding arrangements and operating structures	No. These are general costs of the lender's business and do not relate to a particular loan.

Prepayment fees

- 137** For the purposes of the Act, prepayment occurs where a borrower repays some (**part prepayment**) or all (**full prepayment**) of the unpaid balance of a loan before that amount becomes due for payment.
- 138** The Act allows:
- borrowers to make full prepayment of a consumer credit contract at any time,⁹⁸ and
 - a lender to decline to accept part prepayment where the contract expressly permits it to do so.⁹⁹
- 139** Where a borrower makes prepayment, the lender may charge fees if the contract provides for such fees and the fees (or method of calculating the fees) have been disclosed. The Act allows lenders to charge the following fees:
- A **prepayment fee** to recover the losses caused to the lender by the part or full prepayment.¹⁰⁰
 - A **prepayment administration fee** to recover costs (ie, the cost of processing the prepayment) arising from the part prepayment or full prepayment.¹⁰¹

97. Bad debt write-off in this context refers to the practice of bundling bad debts and attempting to recover the costs incurred across a class of consumer credit contract, rather than any costs arising from pursuing recovery from an individual defaulting borrower.

98. Section 50(1) and (3).

99. Section 49(1)-(2).

100. Section 43(1).

- 140 This section of the guidance relates only to the reasonableness of prepayment fees. A prepayment administration fee is subject to section 44 and its reasonableness is to be assessed against the criteria in section 44.¹⁰²
- 141 A lender can charge a prepayment fee only where the fee relates to:¹⁰³
- prepayment in respect of a fixed-rate contract;¹⁰⁴ and
 - the portion of the unpaid balance for which the interest rate is fixed for an agreed period.
- 142 The fee must not be more than a reasonable estimate of any loss that:
- arises from the prepayment; and
 - is a result of differences in interest rates.
- 143 A lender cannot charge a prepayment fee where a variable interest rate applies to that part of the unpaid balance being prepaid. To be clear, where a loan has both fixed and variable interest rate charges (e.g. 50% fixed, 50% variable) any prepayment fee can only recover a reasonable estimate of loss arising from the prepayment of the part of the unpaid balance that is subject to the fixed interest rate.
- 144 The prepayment fee is designed to calculate a reasonable estimate of the lender's loss arising from the early prepayment. To calculate this loss, the lender must either:
- use the "safe harbour formula" set out in the Regulations;¹⁰⁵ or
 - use an "appropriate procedure" of its own design to calculate a reasonable estimate of its loss.
- 145 A prepayment fee will only be unreasonable if the fee exceeds a reasonable estimate of the lender's loss arising from the prepayment.¹⁰⁶

Calculating a reasonable estimate of loss

The safe harbour formula

- 146 The safe harbour formulation in the Act assumes that the lender will immediately relend the repaid money. The loss suffered is estimated as the difference between the fixed interest rate under the loan and the lender's current retail interest rate.
- 147 The safe harbour formula is based on the concept that if retail interest rates have not fallen, the lender has not suffered a loss. If rates have fallen, the safe harbour formula compensates the lender for its loss.
- 148 The formula takes into account the change in interest rates, the time value of money (by a present value calculation) and the expected decrease in the loan balance over the remaining part of the fixed term.
- 149 A prepayment fee calculated using the safe harbour formula is deemed to be a reasonable estimate of loss.¹⁰⁷

101. Section 43(3).

102. Sections 44(1) and 43(3). For guidance on the reasonableness of prepayment administration fees, see [118] to [127] above.

103. Section 43(2).

104. Section 43(4) defines a fixed-rate contract as a credit contract under which an interest rate is fixed for an agreed period for the whole or a part of the unpaid balance.

105. Credit Contracts and Consumer Finance Regulations 2004, r 8-11.

106. Sections 43, 51 and 54.

Estimation using an alternative method

- 150 Where a lender uses its own alternative procedure to estimate its losses arising from prepayment, it must take care to ensure that the procedure followed does not recover more than a reasonable estimate of the lender's loss.
- 151 In *Avanti Finance* the High Court considered whether the formula used by *Avanti Finance* was an appropriate procedure for calculating a reasonable estimate of its loss on full prepayment. *Avanti Finance* used a procedure of its own design, rather than the safe harbour formula.
- 152 The High Court found that the purpose of the prepayment fee provisions was to prohibit a lender from making a profit out of prepayment.¹⁰⁸
- 153 The Court acknowledged that the common law approach to loss is relevant to the assessment of whether an alternative procedure is appropriate and complies with the Act. Consequently, an alternative formula should do no more than compensate the lender for its actual anticipated losses arising from prepayment. Any amount in excess of that risks being an unlawful penalty. The Court found that the amount charged by *Avanti Finance* did no more than compensate it for its reasonable losses.

How should a lender mitigate its loss on prepayment?

- 154 Regardless of the method used, any alternative procedure to the safe harbour formula should contain an assumption that the lender will mitigate its loss arising from the prepayment of a loan. The key point for lenders to remember is that they have an obligation to act reasonably to minimise the loss they may suffer on the early prepayment of a loan.
- 155 The least controversial approach to mitigating loss is to assume that the lender will immediately relend the repaid money at prevailing interest rates. This is the approach used in the safe harbour formula and in many contracts relied on by lenders.
- 156 However, in some situations an assumption of immediate relending may not be appropriate. In *Avanti Finance* the High Court found that where a lender has "excess capacity" because it has more money to lend than it can actually lend (ie, supply exceeds demand), the lender does not have to assume mitigation by relending the repaid money.
- 157 Other potential mitigation assumptions, which may also be reasonable, include an assumption that the prepaid money will be used to repay existing debt, or that it is otherwise invested to obtain a return (by placing the money in an interest bearing account, for example).
- 158 Where a lender uses an alternative to relending as mitigation, the loss it can recover from the borrower is the difference between the value of the expected interest payments under the contract (but only for the period for which the interest rate is fixed) and:
- the value of interest payments avoided by the debt repayment; or
 - the value of interest payments received on the new investment.
- 159 The lender should also adjust the amount it seeks to recover to recognise the present value of the money repaid. This is done using a net present value calculation that compares the amount repaid to the present value of the future cash receipts from the lenders use of the repaid money.

107. Section 54(2).

108. *Avanti Finance* [31].

The prepayment fee should be adjusted to reflect the net present value of the amount prepaid.

Default fees

160 **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.¹⁰⁹

Most outsourced collection and enforcement functions, relating to steps taken to enforce repayment of a debt, are costs that come within the definition of a default fee.

161 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 creditor for the following:

- (a) any cost incurred by the creditor:
- (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.

162 See [106] to [114] above for guidance on the meaning of:

- the matter giving rise to the fee;
- reasonably compensates; and
- reasonable standards of commercial practice.

163 The key concepts for default fees are:

163.1 the default fee must not exceed the total of any cost incurred by the lender and a reasonable estimate of the lender's loss; and

163.2 the loss recovered must be "a result of the borrower's acts or omissions" – that is only loss caused by the borrower, not by some other borrower or class of borrowers.



109. Section 5 definition.

- 164 The most significant difference between the default and credit fees provisions is that, for a default fee, the lender is also allowed to recover its reasonable losses.
- 165 The common law provides guidance on estimating loss. The standard principles of causation, remoteness and mitigation of loss will apply. Based on those principles, the loss that is recovered through a default fee must be loss of a kind that is within the contemplation of the parties to the loan.
- 166 A default fee that is set in advance to recover loss must reflect a genuine estimation of future loss. It cannot be a penalty or an amount intended to deter the borrower from defaulting. The Code provides this guidance on setting default fees:¹¹⁰
- ... a lender should:
- (a) assess the losses likely to be incurred as a result of the borrower's default; and
 - (b) assess costs likely to be incurred as a result of the borrower's default. The assessment should take into account past experience in relation to the costs incurred as a result of the borrower's default for the same or similar credit products but apply that experience on a forward looking basis to assess costs that are likely to be incurred in the future.

Relationship between the Act's default fee provisions and the common law penalty rule

- 167 The common law penalty rule provides that if a contractual term creates a consequence for a breach of contract, it will be unenforceable if it amounts to a "penalty". Generally, a clause will be a penalty clause if it imposes consequences which are out of proportion to any monetary losses that would be incurred by the innocent party following a breach by the other party.
- 168 Recent case law has considered whether clauses that cover monetary losses not resulting directly from a breach of contract, but which nevertheless protect a party's "legitimate interests", are penalty clauses and therefore unenforceable.¹¹¹ In *Paciocco* and *Honey Bees* the Australian High Court and New Zealand Supreme Court respectively found that the penalty rule does allow for consideration of broader commercial objectives – that is, legitimate interests which extend beyond the loss caused by a breach will not be caught by the penalty rule. The common law penalty rule therefore, does not restrict parties from agreeing monetary consequences which are not transaction-specific.
- 169 However, the common law penalty rule does not alter the specific statutory prohibition on providing for unreasonable default fees in section 41 or the approach to be taken to the unreasonableness test in section 44A. The default fee provisions of the Act provide a different test for unreasonableness. Section 44A expressly only permits consideration of some of the commercial consequences of a borrower's default, being:

110. Responsible Lending Code at [10.5].

111. *Paciocco & Anor v Australia and New Zealand Banking Group Limited* [2016] HCA 28 (*Paciocco*) and *127 Hobson Street Limited & Anor v Honey Bees Preschool Limited & Anor* [2020] NZSC 53 (*Honey Bees*).

169.1 any cost incurred by the lender;¹¹² and

169.2 a reasonable estimate of any loss incurred by the lender as a result of the borrower's acts or omissions.¹¹³

- 170 As such, it is the Commission's view that the broader commercial considerations of the kind considered in *Paciocco* and *Honey Bees* remain excluded by section 44A and the allowable costs and losses which are built into a lender's default fee continue to be transaction-specific.

Third party collection and enforcement costs are generally default fees

- 171 Where a lender outsources the collection of debt or the enforcement of a loan, almost all collection and enforcement costs passed on to the borrower are default fees and are subject to sections 44A and 41. Where the loan is assigned to a collection agency or other third party, the assignee becomes the lender, and all fees it charges are subject to sections 44A and 41.

Some repossession costs are not default fees

- 172 There are two exceptions to the general rule that third party collection or enforcement costs are default fees. Those exceptions are found in sections 83ZB and 83ZE of the Act, which relate to costs payable by a borrower who seeks to reinstate or settle a contract after repossession of secured items. The exceptions include the lender's costs of repossessing, storing or repairing goods or preparing them for sale.
- 173 Where the lender incurs these costs themselves, fees relating to these matters must be reasonable and only relate to the lender's actual reasonable costs.
- 174 Where fees payable under sections 83ZB and 83ZE relate to costs that the lender incurs from a third party who is not associated with the lender,¹¹⁴ the fee is not subject to the reasonableness assessment in section 44A. But the lender must pass on the fee at cost and cannot add a margin to it.¹¹⁵ Fees charged by an associated third party are credit fees to be assessed under sections 44 and 41.

All other third party enforcement costs are default fees

- 175 All other fees charged by the lender to recover third party collection or enforcement costs are default fees and must be reasonable whether or not the third party is associated with the lender. Whether or not the third party is associated with the lender will, however, be relevant in assessing whether the fee is consistent with reasonable standards of commercial practice.



112. Section 44A(1)(a).

113. Section 44A(1)(b).

114. Associated has a special meaning: see s 8A of the Act and [192] below.

115. Section 45. See also section on third party fees from [180] below.

- 176 In assessing whether a default fee that seeks to recover third party collection or enforcement costs will be reasonable, the Commission will consider:
- 176.1 whether the fee recovers no more than the actual, or reasonably estimated, cost incurred by the lender (ie, the amount charged, or expected to be charged, to the lender by the third party). The third party fee may incorporate a profit component, provided that the fee paid by the borrower is not unreasonable;
 - 176.2 whether the type of fee, and the amount of the fee, is consistent with reasonable standards of commercial practice (for example whether the amount of the fee is significantly higher than would have been charged by a reasonable collection agent);
 - 176.3 the relationship between the lender and collection agent. For example, if the collection agent is associated with, or otherwise closely connected to the lender, we will consider whether the lender is using the collection agent to avoid the prohibition against recovering profits or non-transaction specific costs; and
 - 176.4 whether, in the circumstances, it is otherwise reasonable for the lender to recover a fee of that amount from the borrower. For example if the amount of the default fee significantly exceeds the amount in default or the lender is unreasonably receiving payment or commission from the third party.
- 177 In *Sportzone* the Supreme Court sounded a note of caution about the argument that fees need not be reasonable for activities that have been contracted out to third parties:¹¹⁶
- ... we should not be taken to agree that a fee paid to a contractor would be reasonable in all circumstances, regardless of the level of the fee and the relationship it bears to the actual costs of providing the contracted-out service.

Oppression provisions also apply

- 178 Additionally, if a lender provides for a fee in a credit contract, (whether a default fee or a section 83ZB or section 83ZE fee), that seeks to recover third party collection or enforcement costs, that fee can also be considered in the context of the oppression provisions in the Act. Irrespective of whether the fees provisions apply, these fees must not be oppressive.

Default interest

- 179 A **default interest rate** is a higher interest rate charged if a borrower breaches a credit contract by, for example, missing payments or going over a credit limit.¹¹⁷ There is no restriction under the Act on the default interest rate that can be charged provided that it is:
- disclosed; and
 - not oppressive.

116. *Sportzone* Supreme Court judgment at [103].

117. Section 5 definition.

- 180 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.¹¹⁸ The lender cannot call up the unpaid balance of a loan if there is a default and charge default interest on the whole of that balance.¹¹⁹

Example

Salesi enters into a loan with Lender K for \$5,000 on 7 June 2015. He misses the first payment of \$100 due on 21 June 2015. Lender K can charge default interest on the \$100 missed payment only (not on the full \$5,000 owing), and only while Salesi remains in default.

TABLE 3: Default fees¹²⁰

Cost	Can this cost be recovered within default fees?
Staff costs	An appropriate apportionment of the wages, salaries, performance schemes and ancillary costs of staff may be charged for those staff involved in default fee activity. Costs of training staff are not recoverable.
Depreciation	If the depreciation cost relates to assets used in relation to the matter giving rise to the fee, an appropriate apportionment of the depreciation cost may be charged for assets used. The lender cannot claim depreciation on assets where the cost of those assets has already been recovered by other fees or some other means, or on assets that are not used in close connection with default activity of the particular loan or class of loans.
Costs related to debt recovery	If the lender can establish a sufficiently close connection between debt recovery costs and the particular default, an appropriate apportionment of the costs can be charged.
Administration costs	If administration costs not otherwise mentioned in this table are incurred in close connection with the default fee activity of a particular loan or class of loans, an appropriate apportionment of those costs may be charged. Default fees should not be used to recover overheads that are not transaction-specific.
Premises costs	If the lender can establish a sufficiently close connection between the premises costs and the default fee activity, an appropriate apportionment of premises costs may be charged.
IT costs	If the lender can establish a sufficiently close connection between the IT costs and the default fee activity, an appropriate apportionment of the IT costs can be charged.
Marketing and advertising costs	No. These are not costs of a borrower's default.

118. Section 40(2).

119. Section 40(2B).

120. This table discusses costs that can or cannot be recovered. It does not address losses that can be recovered.

Bad debt write-offs or an increase in provision for doubtful debts ¹²¹	No. These costs are not caused by the particular default to which the default fee relates.
Head office costs	If the lender can establish a sufficiently close connection between the head office costs and the particular default, an appropriate apportionment of the head office costs can be charged.
Cost of capital	No. These are not costs of a borrower's default.
Profit/Return on capital	No. A lender cannot recover its profit or a return on its capital through default fees. These are not costs of a borrower's default. A lender may however pass on reasonable third party fees that contain a component of third party profit. ¹²²
Declined loan applications	No. These are not costs of a borrower's default.
Entertainment costs	No. These are not costs of a borrower's default.
Costs relating to lender's initial funding arrangements and ongoing operating structures (excluding credit control)	No. These are not costs of a borrower's default.
Deterrence from defaulting	No. The fee must genuinely estimate future loss. It cannot be a penalty or an amount intended to deter a borrower from defaulting. Any disincentive to defaulting can be adequately provided for in a default interest rate.

Third party fees (excluding default fees)

- 181** The Act recognises that, under some loans, fees payable to third parties (**third party fees**) are permissible for a lender to pass on to the borrower. Those fees and the test for assessing their reasonableness are set out below.

What are third party fees?

- 182** Third party fees are fees or charges for amounts paid or payable by the lender to another person, body or agency, for which the lender is entitled to seek reimbursement from the borrower.¹²²
- 183** Common third party costs include:
- Brokers fees.
 - Credit-related insurance paid to an insurer (where the insurance from that insurer is not required by the contract).¹²³
 - Personal Property Securities search or registration fees payable to the Ministry of Business Innovation and Employment.
 - Mortgage registration fees payable to Land Information New Zealand.

Restrictions applicable to third party fees

- 184** For arms-length third party fees, the Act requires that:¹²⁴

121. Bad debt write-off in this context refers to the practice of bundling bad debts and attempting to recover the costs incurred across a class of consumer credit contract, rather than any costs arising from pursuing recovery from an individual defaulting borrower.

122. Section 45.

123. Where a lender requires insurance to be taken out from a particular insurer, any fee charged is a credit fee and is to be assessed under s 44. See the definition of credit fee in s 5 of the Act.

184.1 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.

184.2 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.

184.3 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.

185 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. The fee cannot simply be passed on at cost, unless it is reasonable.¹²⁵

Payments to associated persons

186 As noted above, where third party fees are paid to an “associated person” of the lender they are treated as credit fees and must be reasonable.¹²⁶ The commentary at paragraphs [117] to [136] above applies to these fees. This amendment was enacted in 2015 and potentially captures charges that had previously been simply passed on by the lender at cost to the borrower.

187 Lenders cannot contract out loan-related functions to associated third parties as a way of avoiding the strict cost recovery restrictions in the fees provisions.

188 The definition of “associated person” includes:¹²⁷

- A director or officer of the lender.
- A natural person who is related (within the fourth degree of relationship) to a director or officer of the lender.
- A person who is married or in a relationship in the nature of marriage with a director or officer of the lender.
- A person who is directly or indirectly able to exercise control over the affairs of the lender.
- Where the lender and third party are both companies, they are associated where:
 - One party is a holding company or subsidiary of the other.
 - One party owns or controls shares that in aggregate carry the right to exercise or control the exercise of 20% or more of the voting power at meetings of the other.
 - Both parties have the same holding company within the meaning of section 5 of the Companies Act 1993.
 - If a third person owns or controls shares in each of them that carry the right to exercise or control the exercise of 20% or more of the voting power at meetings of each of them.

124. Section 45.

125. Section 5 definition of credit fee at (a)(iii).

126. Section 5 definition of “credit fee”; see also s 41.

127. Section 8A.

Commission payable on credit-related insurance

- 189 A lender is entitled to receive a reasonable commission on credit-related insurance sold by a third party insurer to the borrower.¹²⁸
- 190 A lender cannot receive a commission where:¹²⁹
- 190.1 the insurance is mandatory under the contract and the lender requires the borrower to take it from a particular insurer.
 - 190.2 the cost of the insurance is financed under the credit contract (eg, it is added to the outstanding balance) and the lender has breached the Principles relating to insurance contracts.¹³⁰

Example

Lender L fails to make reasonable enquiries that the insurance product will meet the requirements and objectives of the borrower. Lender L cannot charge a commission for the insurance product and, if it does, it must immediately credit or refund the amount of the commission.

Broker fees

- 191 Broker fees are perhaps the most common third party fee. The Commission sees many loans under which a broker's fee is payable from the proceeds of the loan.
- 192 Broker fees that are charged under the loan will be credit fees. Such fees must be reasonable.¹³¹
- 193 Fees charged by a broker that are not associated with the lender – but are included in the loan – are not subject to the reasonableness assessment in sections 41 and 42 of the Act. Such fees are however, subject to the requirements of section 45 and to the oppression provisions in Part 5 of the Act.
- 194 As with other fees, the service must have been provided before a broking fee can be charged. Where a loan provides for a broker's fee, but no broking service has been provided, or the borrower is unaware that a broking service has been provided, then any attempt to recover the broker's fee is likely to be misleading and in breach of the FT Act.

Penalties and consequences for unreasonable fees

- 195 There are significant consequences for breaching the fees provisions.
- 196 Lenders can be liable for pecuniary penalties up to \$600,000, if they provide for an unreasonable fee in a credit contract.¹³² Further, a court may make a range of orders against a lender that breaches the reasonable fees restriction,¹³³ including ordering refunds and compensation.

128. Section 45(5).

129. Section 45(6).

130. Section 9C(5).

131. *Harmony* at [100].

132. Section 107A(1)(a)(iii). Breaches of section 41 before 20 December 2019 are offences, punishable by a maximum fine of \$600,000 (under previous section 103). Breaches of section 41 between 20 December 2019 and 30 April 2020 are offences, punishable by a maximum fine of \$600,000 (previous section 103) and can also lead to pecuniary penalties of up to \$600,000 (section 107A(1)(iii)).

133. Section 94.

- 197 For more details on the exercise of the Commission’s enforcement discretion, please see our Enforcement Response Guidelines, which provide guidance on the Commission’s general approach to enforcement.¹³⁴ The Criminal Prosecution Guidelines, which form part of that document, give guidance on when we are more likely to take criminal proceedings.



134. For further information see our Enforcement Response Guidelines at <http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/>.

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