

## COMMENT

# 'Loan shark' changes will curb consumer borrowing

Sarah Simmers

Changes to consumer lending laws have been marketed as "tough new laws for loan sharks."

But the Credit Contracts and Consumer Finance (CCCF) Amendment Bill, expected to be tabled in Parliament in a few months, will have much wider implications for borrowers.

The key change proposed is the introduction of responsible lending obligations. As in Australia and the UK, banks and finance companies will be prevented from making a loan unless they are satisfied the borrower can repay without substantial hardship.

At the moment, when a lender assesses a loan application, it has no obligation to consider whether the applicant can repay the loan. Some lenders ask a few questions about their borrowers' financial situations. Some ask none at all.

Decisions are often based solely on the value of the assets the lender is taking security over or on average rates of repayment. The new laws will prevent this.

Although the changes primarily target unscrupulous lenders, they will in fact apply to all consumer lending. This includes home loans, credit cards, hire purchases, personal loans and car finance. For all of those products, expect lenders to ask more questions before approving finance.

Lenders will pay close scrutiny to people with a poor credit history, in a tight financial position or with limited earning ability.

These people are likely to find their lending options limited or may be denied credit entirely.

Credit law focuses on disclosing full details of a loan to the borrower; the assumption being that they are in the best position to decide if the loan is right for them. The new laws will

instead put an obligation on lenders to ensure loans are appropriate for borrowers.

Banks and finance companies will have a duty to "look out" for their customers. A borrower will have the scope to argue that the loan they applied for and signed up for should not have been made by the lender. This approach has been criticised by some as overly paternalistic.

The additional protections for borrowers will also mean increased costs for lenders. They will need to make changes to their documents, systems and processes. These will likely be passed on to borrowers while the additional compliance obligations may even cause some finance companies to exit the consumer market.

An interesting feature of the changes is the adoption of principles-based drafting. Australia has prescriptive responsible lending rules but the Ministry of Consumer Affairs decided against this approach and instead adopted broader wording.

The thinking is that this approach gives lenders more flexibility about how they comply with the new laws and allows for future changes in technology. However, this gives lenders less certainty about what they need to do to comply with the new laws.

The intention behind the reforms is clear and nobody can argue with the sentiment of responsible lending. However, the lack of certainty may cause banks and finance companies to become defensive in some of their lending practices.

For example, there will be an obligation on lenders to provide borrowers with "sufficient information to make informed decisions." There is uncertainty about exactly what information a borrower will need to be provided with, when that information must be provided and the format in which it

must be given. Banks and finance companies may end up sending screeds of information in an effort to ensure they do not fall foul of the new laws.

The broad wording will also make it more difficult for the Commerce Commission, which is tasked with policing the new laws, to prove a breach.

The changes in the draft bill target fringe lenders preying on vulnerable consumers. However, in most cases, unscrupulous behaviour by loan sharks breaches current laws. This has led some industry participants to question whether the loan shark problem ought to be tackled by better enforcement of the existing laws, which have only been in force seven years, rather than by overhauling them.

Either way, appropriate resourcing for the commission will be important. For a fringe lender that fails to comply with the current laws, introducing additional laws may just push them further underground.

As well as targeting loan sharks, the changes are driven by a concern at the effect over-lending can have on borrowers and on society generally. In the US, irresponsible household lending was seen as a cause of the credit crunch. Political concern has been expressed at this country's household debt level and the reforms may be seen as a means of reducing that debt.

**What's next:** The Minister of Consumer Affairs will receive a report on submissions about the proposed law changes. Cabinet approval for the content of the Credit Contracts and Consumer Finance Amendment Bill will then be sought and likely to be tabled in Parliament in October.

The changes are expected to come into force mid-2013. They will be enacted as amendments to the Credit Contracts and Consumer Finance Act 2003. Creditors who over-lend in contravention of the new laws can be banned from the industry.

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## IN TRAY

Inspired by the New Zealand Herald's comparison of MP Louisa Wall with American civil rights icon Rosa Parks, In Tray presents a who's who of other famous New Zealanders and the legendary world figures we think of them with ...

## The hall of fame

**Mai Chen:** Enduring the racism and bigotry that was New Zealand in the early 1970s may have spelt the end of a lesser young woman in an immigrant family, but, as the country's greatest constitutional lawyer has gone on to write, "I grew up in a household where the wisdom of top athletes was seen as the key to success in all areas of life." Among the many times this has been borne in on her in the course of a remarkable career as a lobbyist, commentator, and parliamentary expert was during the gruelling hours last year "when in the midst of my own marathon effort to write a book while running a law firm, Dad began coaching me with Olympic insights once again." Not for nothing is this national icon known as the Peter Snell of the country's law community.

**Alan Hubbard:** Were it not for a series of unfortunate misunderstandings that led to the collapse of South Canterbury Finance, its late chairman would not only be remembered as the driving force behind the company's growth into the largest financial institution but one of the most generous providers of free money that the country has ever seen—Timaru's answer to Warren Buffett.

**Bryan Gould:** The collapse of the Lehman Brothers empire and the subsequent chain of events contributing to the global financial crisis took millions of people by surprise—but not the Oxbridge-educated Rhode's scholar and former vice chancellor of the University of Wombato, who has not lost an opportunity since to write a column saying, "I told you so" and—perhaps most memorably—"that chap John Key has a very tenuous grasp on economics." If only business leaders and politicians had listened to Professor Gould then. If only they listened to him now. And if only everyone else recognised him as the heir-apparent that he is to John Maynard Keynes.

**Celia Wade-Brown:** Anyone who has visited the country's capital before and after the election of its dynamic mayor will not be unaware of the city's dramatic change on the current leader's watch. From a landlocked village of no more than a few thousand, mostly unemployed vagrants and petty criminals to today's magnificent, bustling harbour city that is home to hundreds of thousands of newcomers, Wellington owes its "absolutely, positive" transformation over just a couple of years to one woman, Her Worship Ms Wade-Brown, or as she is better known around the world, the Eva Braun of the South Seas.

**Hone Harawira:** Reviled, criticised and disowned by some in the establishment, the Mana Party leader has nevertheless managed to inspire a generation with his unmatched ability to verbally bully people he doesn't like [Surely "to continue the fight against economic injustice"?—Ed], leading many observers to wonder if he might not ultimately occupy as great a place in the international hall of fame as Bishop Tutu.

**Barack Obama:**

This may go down as the week in which the world reconnected with Barack Obama, thanks to what promises to be a stirring speech to delegates at the 2012 Democratic National Convention in Charlotte, North Carolina, delivered with the president's trademark aplomb and soaring oratory. But as millions watch Mr Obama address supporters in Charlotte's open-air football stadium, the thoughts of many millions more will naturally go to the historical political figure with whom the American leader bears the closest resemblance. Who in the United States or indeed anywhere in the world today won't also be thinking of David Lange's epoch-defining speech at the Oxford Union Debate and his unforgettable [That's enough ludicrous comparisons.—Ed]



## Don't dismiss alcohol self-regulation

Annabel Young  
Wellington

The alcohol sector has been given the opportunity to sort itself out with a clear threat that the government will act if it is not satisfied with the changes achieved in the marketing and sale of pre-mixed drinks known as RTDs.

There is a good case to make that such self-regulation is likely to be significantly more effective than regulations handed down from on high.

There is a good precedent for this in the way that tax policy and legislation is developed. Since the 1994 Richardson Commission mandated the Generic Tax Policy Process (GTPP), it has been well accepted in New Zealand that the develop-

ment of sound tax policy occurs when the foxes work with the game-keepers in the development of the rules.

GTPP allows officials to test out their ideas well before they become legislation with the outcome being that the opportunities for gaming the tax system are addressed or removed.

This is not self-regulation but it is the acceptance that the people to be regulated (and their representatives) will deal honestly with the process with an outcome that works better for everyone.

Looking wider, Inland Revenue's policy development processes are also mandated by the Ayres Braithwaite principles, for example, in their book

Responsive Regulation: Transcending the deregulation debate.

This supports the view that close involvement of the sector to be regulated will, first, produce better targeted regulations and, second, that the regulations will be better complied with.

One effect of working with the sector is that regulations can be targeted to educate the willing, assist the struggling and penalise the deliberate offenders. This has the double benefit of reducing bureaucratic burden whilst also targeting the penalty provisions.

A feature of the Ayres Braithwaite principles is that the regulatory framework is backed up by a "big gun" to incentivise proper compliance. Deliberate offenders

need to feel the effect of the big gun both as a penalty and as an example to others.

The big gun is a real threat to anyone who is thinking about cutting corners so that they are more likely to ensure that they do comply.

The RTD producers face the real threat that the self-regulation option will be removed if they do not come up with rules that are acceptable to the minister, the government and the wider voting public.

There is an even chance the sector will set rules that are stronger and better enforced than would be the case if the government was trying to impose them.

Letters to the editor should be emailed to editor@nbr.co.nz, faxed to 09-912 2754 or sent to PO Box 1734, Auckland