Introduction for Creditors

CREDIT CONTRACTS AND CONSUMER FINANCE ACT 2003

Introduction	2
Overview of the Act	2
Definitions and key concepts	3
Debtor's purpose when entering into a credit contract	5
Required information disclosure	6
Disclosure standards and methods	12
Debtor's right to cancel	14
Interest charges and fees	16
Payments	20
Hardship applications	22
Consumer leases	23
Credit-related insurance	24
Reopening oppressive credit contracts	25
Transitional provisions	25
Key changes in the Act	26
Key terms	28
For more information	29
Disclaimer	30

BUSINESS NOTES

INTRODUCTION

This publication introduces credit providers (creditors) to the Credit Contracts and Consumer Finance Act 2003 (the Act).

The Act's sections that cover buy-back of land transactions took effect from 14 October 2003, while all other parts of the Act take effect on 1 April 2005. The Act repeals the Credit Contracts Act 1981 and the Hire Purchase Act 1971. After April 1 2005, creditors (you) can choose to switch all existing credit contracts to comply with the Act.

This *Business Note* looks at key definitions and concepts in the Act and your obligations relating to disclosure requirements, calculation of fees, charges and interest, and oppressive conduct. A list of key changes the Act introduces and a glossary of key terms and definitions used in the Act and in this publication, are also included. Key terms listed in the glossary are highlighted in green in the text.

A subsequent publication by the Commerce Commission will provide information on penalties and remedies. It will cover issues such as what happens if you do not disclose information as required by the Act.

This publication does not cover the section of the Act relating to buy-back of land transactions. More information on this is available on the Ministry of Consumer Affairs' website, www.consumeraffairs.govt.nz, or through our consumer factsheet, *Home Buy-back Schemes*.

Please note that at the time of publication, regulations under the Act were still being developed and had not been finalised. However, the proposed regulations substantially reflect those put forward in the Ministry's discussion paper of November 2003. This paper is available on our website at www.consumeraffairs.govt.nz in the Policy and Law section's discussion paper index. In particular, the two prepayment formulas to be prescribed in the regulations are unchanged from the formulas proposed in the discussion paper.

Objectives of the Act

The Act is designed to provide transparency in dealings between creditors and debtors. The Act allows creditors considerable flexibility in the manner in which they comply with their obligations under the Act, while remaining strong against oppressive conduct by creditors.

OVERVIEW OF THE ACT

The Credit Contracts and Consumer Finance Act 2003 (and associated regulations):

- defines key concepts such as credit and consumer credit contracts
- requires you to disclose key information to debtors under consumer credit contracts and consumer leases
- regulates methods of interest charging, fees and payments
- allows for changes to a contract's terms on the basis of unforeseen hardship to the debtor
- regulates land buy-back transactions to provide rules about fees and ensure the disclosure of key information and independent legal advice to debtors
- restricts creditors and lessors from making unreasonable requirements as to the terms on which a debtor or lessee is to take out or obtain credit-related insurance
- sets up a penalty and enforcement regime, including enforcement by the Commerce Commission
- provides for reopening oppressive credit contracts and banning orders against creditors who the Court decides are not suitable to be in the business of providing credit.

What is credit?

The Act defines "credit" (Section 6) as being provided when, under a contract, a person grants a right to another person to:

- defer payment of a debt, or
- incur a debt and defer its payment, or
- buy property or services and defer payment for that purchase (in whole or part).

What is a credit contract?

The Act defines a "credit contract" (Section 7) as a contract under which credit is or may be provided.

If the debtor and creditor have agreed on a combination or series of contracts, and in substance credit is provided under those contracts (even though none of the contracts on its own is a credit contract), the contracts are treated as a credit contract formed at the date the **last** contract in the series was made.

Credit contracts include:

- a loan of money
- a credit sale – a sale of goods or services where payment of the purchase price is deferred (previously commonly referred to as a hire purchase agreement)
- a credit card or charge card facility used for purchases and/or cash advances
- a bank overdraft
- a conditional sale of either real or personal property.

Credit contracts do **not** include:

- an ordinary contract for hiring or leasing goods
- a layby sale
- a lease of land
- a block discounting or factoring agreement.

What is a consumer credit contract?

The Act defines a "consumer credit contract" (Section 11) as being a credit contract in which:

- the debtor is a "natural person", ie, they are not a company or incorporated society
- the debtor enters into the contract for personal, domestic or household purposes,

and one or more of the following applies:

- an interest charge or fee is, or may be, payable in return for the credit (this does not include default fees)
- a security interest is taken in connection with the credit contract.

In addition, one or more of the following **must** apply:

- the creditor is in the business of providing credit or provides credit in the course of a business
- the debtor and creditor are introduced by a paid adviser or a broker.

Credit contracts that are **not** consumer credit contracts include:

- contracts for the sale of property or goods where the agreed price must be paid within two months
- where credit is provided because a person has overdrawn their bank account without an agreed overdraft facility
- where the debtor is acting as a trustee for a family trust
- contracts primarily for investment purposes.

Examples

The following examples illustrate the above rules:

- *Judith enters into a loan agreement with a bank to buy a family home. The contract is a consumer credit contract.*
- *Garry enters into a loan agreement with a bank to buy an investment rental property. The contract is not a consumer credit contract as Garry's purpose is for investment rather than for a domestic purpose.*

What is a consumer lease?

A "lease" is a contract for the hire of goods. A typical lease is not a credit contract as it does not meet the definition in Section 6, ie, the lessee does not incur a debt or defer payment of a debt.

The Act defines a "consumer lease" (Section 60) as having been entered into primarily for personal, domestic or household purposes. The lease must also either be for a term of more than one year, or provide that the lessee has an option to buy the goods they are leasing.

Note: The definition of a consumer lease under the Act applies only when the lessor is in the business of leasing goods. This is discussed further in *Consumer leases* on page 23.

However, the Act considers a lease to be a credit contract when:

- the payments under the lease equal or exceed the cash price of the goods being leased, or
- the payments under the lease do not equal or exceed the cash price, **but** the lessee has an option to buy the goods for less than a reasonable estimate of their fair market value at the end of the lease.

Examples

The following examples of transactions that are leases and credit contracts assume the consumer enters into the transaction for personal, domestic or household purposes.

- *Debbie enters into a contract to hire a car. The car's cash price is $20,000. The rental payments for the lease are $300 per month. The lease term is 36 months. The contract is for a term of more than one year but the total payments of $10,800 are less than the cash price, so the contract is a consumer lease.*
- *Julie enters into a contract to hire a car. The car's cash price is $20,000. The rental payments for the lease are $340 per month. The term of the lease is 36 months. At the end of the term Julie may buy the car for $12,000 – its expected market value. The contract is a consumer lease because Julie has an option to buy and the term is for more than one year, even though total payments are less than the cash price.*
- *John enters into a contract to hire a car. The car's cash price is $20,000. The rental payments for the lease are $330 per month and the final payment is $12,000. Total payments are $23,880. The term of the lease is 36 months. This contract is a credit contract as the total payments exceed the car's cash price.*
- *Sarah enters into a contract to hire a car. The cash price of the car is $20,000. The rental payments for the lease are $400 per month. The term of the lease is 36 months. At the end of the term Sarah may buy the car for $8,400. As the option price is substantially below the car's expected market value ($12,000) the transaction is a credit contract.*
- *Simon hires a television for $25 per week. The cash price is $2,500. The lease has no term and Simon may return the television and stop paying whenever he chooses without further obligation. Simon may also buy the television and his previous payments will count towards the purchase price. This contract, commonly known as a "rent to own", is a consumer lease.*
- *Nigel hires a television at $25 per week. The cash price is $2,500. The lease has no term and Nigel may return the television and stop paying whenever he chooses without further obligation. The contract is an ordinary hire contract and is* ***not*** *regulated by the Act.*

DEBTOR'S PURPOSE WHEN ENTERING INTO A CREDIT CONTRACT

Unless you can establish otherwise, it will be assumed that the debtor has entered into the contract for consumer purposes.

How can I (the creditor) be certain what a debtor's purpose is when entering into a credit contract?

If you are not certain what the debtor's purpose is when entering into a credit contract, the Act (Section 11, *Meaning of consumer credit contract*) allows you to take a declaration from a debtor as to their purpose. If they declare they are entering into the contract primarily for business or investment purposes, the contract is **not** a consumer credit contract.

You may rely on the declaration as evidence of the debtor's purpose. However, if the person who took the declaration knew, or had reason to believe, that the debtor was in fact entering into the contract for personal, domestic or household purposes the declaration will be ineffective. It does not matter who took the declaration. You should be wary before relying on declarations taken by brokers or other third parties.

To be effective, a declaration must be in writing in a separate document that the debtor has confirmed they have read and understood. If a declaration is not in this form, you will lose the benefit of the declaration and will have to rely on other evidence to establish that the contract is not a consumer credit contract.

What if the debtor enters into the contract for personal purposes but later uses the credit for business purposes, or vice versa?

The contract is established as a consumer credit contract (or otherwise) depending on the debtor's purpose **at the time they entered it**. It is irrelevant if their subsequent use of the credit differs from this. However, in absence of other information, their use of the credit may be evidence of their intentions in entering the contract.

Examples

- *Sally enters a credit contract to buy a vehicle and intends using it for her sales business. You take a declaration to that effect. However, Sally later uses the car for her personal transport.* ***As at the time of entering*** *the contract Sally's purpose was business related, it is not a consumer credit contract.*
- *Paul borrows $100,000 for the purpose of renovating his house, but uses it to build an office.* ***Because at the time of entering*** *the contract Paul's purpose was domestic, the contract is a consumer credit contract.*

What if the debtor's purposes are still unclear?

In some cases the debtor's purpose may remain unclear, or you may not wish to inquire as to their purposes. For example, if the majority of your customers obtain credit for domestic purposes, it may not be efficient to inquire as to each debtor's purpose or to establish separate systems for business and consumer credit.

In this case, you may choose to document all your contracts as consumer credit contracts. By doing so, the Courts may not apply the most serious consequences that may arise if they subsequently determine that a contract is a consumer credit contract but you have not fully complied with your obligations under the Act relating to consumer credit contracts.

What if I document a business credit contract as a consumer credit contract?

If it is later shown that the debtor entered the contract for business purposes, it will not be a consumer credit contract. This means that in a dispute, the debtor cannot claim the penalties and remedies that are only available to consumer debtors.

REQUIRED INFORMATION DISCLOSURE

The Act is based on a principle of transparency in dealings between creditors and debtors. As such, the Act requires creditors to disclose information to debtors at various stages of the consumer credit contract.

The Act requires five types of disclosure:

- initial disclosure
- continuing disclosure
- variation disclosure
- request disclosure
- guarantee disclosure.

Initial disclosure

When is initial disclosure required?

Under a consumer credit contract, you must ensure you disclose to the debtor as much of the *key information* (as set out in Schedule 1 of the Act) that applies to the contract – either before the contract is made or within five working days of the day it is made.

What is the *key information* that I must provide?

You must provide any of the following information that applies to the credit contract. You do not have to disclose information that is not applicable to the credit contract. If, for example, you are providing only a single advance you do not have to disclose any subsequent advance information and you do not have to enter *subsequent advance* on the disclosure statement:

- *Your (the lender's) full name and address*
- *Initial unpaid balance*
  - The unpaid balance as at the statement's specified "effective date". This accounts for every payment the debtor made on or before that date.
  - The disclosure statement must separately specify the amount and a description of each advance, charge, or payment accounted for in the unpaid balance.

The *initial unpaid balance* refers to the amount the debtor owes when the disclosure statement is prepared. This will typically include the amount of any advance provided to the debtor, plus fees imposed at the time of entering into the contract (eg, establishment fees) and insurance contracts or warranties financed under the contract.

Do I have to disclose the cash price of goods I have sold on credit?

Yes, because the cash price of goods sold on credit is an advance. You must describe the advance in terms of the cash price of any goods bought on credit.

Do I have to disclose any trade-in paid in connection with a credit sale?

Yes, as a trade-in is regarded as a payment. You must disclose an amount and a description of any payment accounted for in the unpaid balance.

- *Subsequent advance(s)*

The amount, a description, and the timing of each advance, charge or payment to be made after the disclosure statement's effective date.

- If credit will be provided in stages, eg, for a building loan, you must disclose the amount and timing of the subsequent advances.
- If the contract involves a single advance to be provided after the date you prepared the disclosure statement, you must disclose it as a subsequent advance.

A revolving credit contract usually involves a large number of subsequent advances of amounts drawn at the debtor's choosing. As the amount and timing of these advances **will not be ascertainable** at the time of making disclosure, you do not have to disclose them.

- *Total advances*
  The total of all advances made, or to be made, in connection with the contract.
- *Credit limit*
- *Annual interest rate*
  - The annual interest rate or rates, expressed as a percentage.
  - If there is more than one rate, each rate, and how it applies.
  - If the rate is fixed for the term, or any part of the term of the contract, the period during which the rate is fixed.
  - If an annual interest rate is determined by referring to a base rate, you should describe how you determined the annual interest rate by:
    - naming or describing the base rate
    - stating the margin or margins (if any) above or below the base rate that are applied to determine the annual interest rate
    - stating where and when the base rate is published or how the debtor may find it
    - providing the current annual interest rate or rates.
- *Method of charging interest*

  How interest charges are calculated, and how often they are debited to the debtor's account.
- *Total interest charges*

  The total interest charges payable, but only if the contract would be paid out within seven years of the date on which credit is first provided, on the assumption that:
  - in the case of an annual interest rate, the rate disclosed will not vary over the contract term or any shorter period for which it applies
  - in the case of a variable interest rate, the rate applied over a period is the same as the rate specified when the disclosure statement is prepared
  - the debtor will make required payments at the times the contract requires.
- *Interest-free period*

  If the contract involves an interest-free period, the length of the period and when interest will begin to accrue.
- *Credit fees and charges*

  A description of the credit fees and charges, other than interest charges, that are, or may become, payable under the contract (unless the fees are disclosed under *initial unpaid balance*). Where ascertainable, this must include the amount of each fee or charge and when it is payable. If this is not ascertainable, include the method for calculating the fee or charge.
- *Payments required*

  If more than one payment is to be made, you must specify the payment amounts or the method of calculating them.

  Where you can – but only where the contract would be paid out within seven years of the date on which credit is first provided (based on the assumption that the debtor will make payments required by the contract at the times required) – you must include the number of payments and the total amount of the payments. You must also include when the first payment is due and the payment frequency (eg, weekly/monthly). If a different amount is required for any payment, eg, a final balloon payment, this must also be disclosed.
- *Full prepayment*

  If the contract allows you to recover a charge as compensation for your reasonable loss in the event of full prepayment, you must disclose how this charge is calculated.

  In order to make this disclosure understandable, you should attempt to describe in words the principle of the calculation you will use. Simply stating an actuarial formula may be difficult for the debtor to understand. You may choose to use a statutory procedure prescribed in regulations under the Act. If so, use of this procedure should be disclosed.

- *Security interest*

  Describe any security interest that is, or may be taken in connection with the contract. This includes any personal and real property that is subject to, or proposed to be subject to, a security interest. You must include how much of the debtor's obligations to you are secured.

  You should also disclose whether the security interest taken in connection with the credit contract also secures any subsequent contracts the debtor may have with you.

- *Default interest charges and default fees*

  Describe any default interest charges and fees that may be payable under the contract, including how and when they will become payable.

- *Debtor's right to cancel*

  You must include a statement of the debtor's rights, unless the contract is a revolving credit contract. The statement must use the exact wording provided in the Act. *See Statement of right to cancel* on page 15 for more information on how you must do this.

- *Continuing disclosure statements*

  Include how often you will provide continuing disclosure statements unless continuing disclosure is not required (see *Continuing disclosure* on this page for more information).

- *Consent to electronic communications*

  If the debtor consents to receive notices or other communications from you electronically, whether with an electronic communication or otherwise, you must include a statement to that effect.

  You could disclose consent to electronic communications alongside the debtor's name and address in order to provide them with complete contact details.

- *Other items*

  You must include any other information or warnings prescribed by regulations as *key information* concerning a consumer credit contract.

Do I have to disclose anything else to the debtor at the outset of the contract?

You must give or send the debtor a copy of all the contract's terms and conditions not disclosed under the *key information* (other than terms implied by law), either before the contract is made or within five working days of the day on which it is made.

For example, if you have a contract document or a booklet of standard terms and conditions you should provide this to the debtor within five days of making the contract.

You **must** provide this information to the debtor. It is not sufficient to leave it to the debtor to ask for it.

You must also ensure that the terms of any credit-related insurance policy taken out in connection with the credit contract are disclosed to the debtor if you arranged the insurance. This information must be disclosed within 15 days of the day on which the credit related insurance is arranged.

You will be considered to have **arranged** the insurance if you (or a related company):

- are the insurer
- act as an agent for the insurer
- have received a commission from the insurer
- require the debtor to take insurance from a particular insurer.

Continuing disclosure

What is continuing disclosure?

"Continuing disclosure" is your obligation to disclose information about the debtor's account periodically during the credit contract.

Who has to make continuing disclosure?

All creditors have to make continuing disclosure unless they are exempt (see page 9).

This includes creditors providing non-revolving credit contracts.

Who is exempt from continuing disclosure requirements?

Under Section 21 of the Act, continuing disclosure is not required **at all** if:

- the amount of each advance under the contract is known on the date the contract is made, and the contract specifies a schedule of payments that can not be adjusted (other than as a result of a breach of the contract by the consumer).

  This means continuing disclosure is required for any contract that has a **variable** or **floating** interest rate or where you reserve the power to increase interest rates, or
- interest charges and credit fees are not payable under the contract, eg, "free" credit, or
- in connection with the contract:
  - you maintain (at all reasonable times) a website that allows debtors to access the information that would be in a continuing disclosure statement, and
  - the debtor consents to the information being disclosed in this way and to not receiving continuing disclosure statements.

Continuing disclosure is not required **in relation to a particular period** if:

- you cannot reasonably locate the debtor, or
- during the period that would otherwise be covered by a disclosure statement:
  - there have been no debits or credits to the debtor's account and the unpaid balance is nil, or
  - you have written off the unpaid balance and there are no subsequent credits or debits to the debtor's account, or
  - the debtor has breached the contract and you have started enforcement proceedings, or
  - the debtor has been declared bankrupt or died and the Official Assignee or the executor of the debtor's estate has not asked for a continuing disclosure statement.

If you have not made continuing disclosure in relation to a particular period, the next continuing disclosure statement must cover every immediately preceding period for which a statement has not been provided.

When does continuing disclosure have to be made?

Any required continuing disclosure must be made:

- at least every 45 working days for revolving credit contracts
- at least every six months for non-revolving credit contracts.

What do I have to disclose in my continuing disclosure statements?

A continuing disclosure statement must disclose the following information to the extent that applies to the contract:

- the opening and closing dates of the period the statement covers
- the opening and closing unpaid balances
- the date, amount and a description of each advance during the statement period
- the date and amount of each interest charge debited to the debtor's account during the statement period
- the date and amount of each payment made by the debtor, or credited to the debtor, during the statement period
- the date, amount and a description of each fee or charge debited to the debtor's account during the statement period
- how much the next payment is and when it is due
- the annual interest rate or rates during the statement period, expressed as a percentage.

Variation disclosure

What is variation disclosure?

"Variation disclosure" is required after a contract has been changed.

There are two types:

- disclosure after a change to the contract agreed by you and the debtor (Section 22)
- disclosure after you have exercised a unilateral power under the contract (Section 23).

Disclosure of agreed changes

If you and the debtor agree to change the contract, you must disclose full particulars of the change before it takes effect.

Disclosure is not required for changes that:

- reduce other obligations the debtor would have, eg, you agree to waive a fee payable under the contract
- extend the payment time of any payment under the contract, unless the debtor has applied for changes on the grounds of unforeseen hardship (see page 22)
- release the whole or any part of a security interest relating to the contract
- alter the place where payments are to be made.

Disclosure of changes after making unilateral changes

Many credit contracts provide that the creditor reserves the right to make unilateral changes to the credit contract. If you exercise such a power, you must disclose it within five working days of the day the change takes effect.

Note: Section 23 does not empower creditors to make unilateral changes to contracts. This must be specifically provided in the credit contract itself.

However, disclosure is only required when you exercise power in relation to:

- the amount of an interest rate or anything else in relation to how you calculate or apply any interest charge under the contract, or
- the amount, frequency, time for payment, or method of calculation of any payment to be made, or
- the amount, frequency, time for payment, or method of calculation of any fee or charge payable, or
- any other information prescribed by regulations to be disclosed.

You must disclose full particulars of the change to the debtor, within five working days of the day it takes effect.

Disclosure is not required if you exercise a power that:

- reduces obligations the debtor would otherwise have, or
- extends the time for any payment to be made, or
- increases any credit limit under the contract.

Request disclosure

What is request disclosure?

Under a consumer credit contract, a debtor or guarantor may ask you (in writing) to disclose any or all of the following:

- the effect of a part prepayment on the debtor's obligations under the contract
- the amount of any fee or charge payable on a part prepayment and how it is calculated
- the amount required for full prepayment at a specified date and how it is calculated
- full particulars of any changes to the contract since it was made
- the unpaid balance, including the amount of any interest charge outstanding (calculated as at the date the disclosure statement is prepared)
- payment information, such as payment amounts
- a copy of any disclosure statement that was provided or should have been provided before the date of the request.

You must comply with requests for disclosure within 15 working days of the later of these two dates – the date you receive them, or the date when you receive payment of a reasonable fee for the disclosure.

What if I have recently provided this information?

You do not have to comply with a request if you have disclosed the requested information in the past three months, or if you receive the request more than a year after the contract has ended.

Can I charge the debtor?

You may charge a fee for the cost of preparing the requested information. You do not have to provide for the fee in the credit contract, however it must reasonably reflect your costs in preparing the information.

Guarantee disclosure

When you take a guarantee for the performance of the debtor's obligations under a consumer credit contract, you must ensure that you disclose to every guarantor as much of the *key information* as is required for initial disclosure to the debtor within 15 working days (see page 6). You must also provide every guarantor with a copy of the terms of the guarantee.

In most cases, you can do this by providing the guarantor with the same initial disclosure statement you gave the debtor, together with a copy of the terms of the guarantee. You do not have to provide copies of the terms and conditions not covered in the initial disclosure statement (however, it would be good practice to do so).

You must disclose information on any subsequent contract that you enter with the debtor (to which the guarantee applies), within 15 days of the day when the contract is made.

Disclosing changes to guarantors

If, in relation to a credit contract to which a guarantee applies, there is a change to the contract that increases the obligations of the debtor or reduces the time for payment of any payment then you must disclose the changes to the guarantor.

Disclosure must be made to the guarantor regardless of whether the change is agreed between you and the debtor, or you exercise a unilateral power under the contract.

You must disclose changes within five working days of the day the change is agreed to by both parties, or the day on which the change takes effect after you exercise a power.

Do I have to disclose to guarantors of business loans?

No, you only need to disclose to guarantors of consumer credit contracts.

DISCLOSURE STANDARDS AND METHODS

The Act allows flexibility in how information is disclosed to the debtor. However, disclosure requirements are subject to the guiding standard that disclosure must be clear, concise and likely to bring the information to the attention of a reasonable person, and must not be likely to deceive or mislead a reasonable person.

What disclosure documents must I provide?

Required information should be provided to the debtor as a **disclosure statement**.

The following rules apply to all forms of disclosure:

- disclosure must be in writing
- a disclosure statement may be a single document or a series of related documents, and may be included as part of one or more other documents
- where you provide a debtor with a number of facilities (whether or not under the same contract), you may aggregate or separate the disclosure for each facility. For example, if you provide a home loan, a credit card and an overdraft to the same customer, you may disclose information on all three facilities either in a single statement or in separate statements.

Examples

The following would be permitted under Section 32 of the Act (Disclosure standards). You can:

- *disclose the required information within a contract document*
- *disclose key information on a single page accompanied by a booklet of standard terms and conditions*
- *disclose on an internet banking site, as long as the information is always accessible by the debtor (although see below).*

What are the rules for electronic disclosure?

You may disclose information electronically as long as you ensure the information is readily accessible for subsequent use.

Examples

The following are examples of types of electronic disclosure that would probably meet this test:

- *an email with a printable attachment*
- *a word-processed document that can be saved on the debtor's computer system*
- *a web page that the debtor can access when they choose.*

You must ensure the debtor has consented to receiving disclosure electronically. It is also advisable to clearly inform the debtor of the exact format of the electronic disclosure.

What are the disclosure standards?

Section 32 sets out the standards for disclosing information. Disclosure statements must express the information clearly, concisely and in a way that brings the information to the debtor's attention. The statements must not deceive or mislead a reasonable debtor.

The Act allows you considerable flexibility in how you choose to make disclosure, however you must meet the standards specified in Section 32. For example, if you disclose information across several documents or spread disclosure statements throughout a contract document, you must ensure that the *key information* specified in the Act is clear, concise and likely to come to the attention of a reasonable debtor. The overall effect must not be misleading.

The following practices are examples of conduct which is likely to breach the disclosure standard:

- excessive use of fine print
- unnecessary legalese
- illogically sequencing the disclosure information
- illegible copying or printing of a document, eg, providing a badly carbon-copied disclosure statement.

Model disclosure statements

The Act allows you to use model disclosure statements (to be prescribed by regulations). Model disclosure statements represent the Ministry of Consumer Affairs' interpretation of compliance with the disclosure standards (ie, clarity, conciseness and bringing the information to the debtor's attention).

The advantage of using a model disclosure statement is that a creditor can be considered to have complied with the disclosure standard required by Section 32. The model disclosure statements are not compulsory and you are free to choose a different form of disclosure. A decision by a creditor not to use a model disclosure statement does not in itself have a bearing on whether the performance standard for disclosure has been met.

You can also choose to adapt a model disclosure statement to suit your particular business, rather than use the model form in its entirety. However, if you choose to adapt particular items or clauses from the model form, you could not be said to be using the model form. If you choose to adapt the form, ensure your adaptation still complies with the disclosure requirements.

How do I ensure the debtor receives the disclosure?

Section 35 requires disclosure to be made by any of the following methods:

- giving the disclosure statement to the debtor
- sending the disclosure statement by post to the debtor's place of residence or to an address specified by the debtor for this purpose
- in the case of electronic communication, sending the disclosure statement to the information system specified by the debtor for this purpose.

For most purposes disclosure is treated as having been made on the day on which the statement is sent.

Keep a verifiable record of having sent the disclosure.

For the purposes of Sections 27 and 99-102, disclosure is treated as being made four working days after posting the disclosure statement or two working days after being sent electronically.

If you are making disclosure under Section 23 *(Disclosure of changes following exercise of power)* or Section 26 *(Disclosure of changes to guarantors)* regulations provide alternative methods of making disclosure. In these circumstances, you do not have to comply with Section 35 if you:

- display the required information in any physical location you operate that your debtors may visit (such as retail premises), and
- display the information on a website you operate, and
- publish the notice at least once in one or more daily newspapers in Whangarei, Auckland, Hamilton, Rotorua, Hawke's Bay, New Plymouth, Palmerston North, Wellington, Nelson, Christchurch, Dunedin and Invercargill.

Note: These alternative publication methods will only apply in the case of a change to the interest rate or the amount of any fee or charge payable. Any other changes to the credit contract must be disclosed by notice to the debtor.

DEBTOR'S RIGHT TO CANCEL

A debtor may cancel a consumer credit contract by giving written notice to you within three working days after initial disclosure, or at any time if you have not made initial disclosure.

The debtor must refund you any advance they have received under the contract within this time period.

Effect of cancellation

If a consumer credit contract is cancelled, no party is obliged to perform it further.

You must promptly return any property received under the contract to the party from whom you received it, and ensure you release every security interest taken in connection with the contract.

The debtor is only liable to pay you:

- interest at the contract rate for the period for which the credit was provided
- your reasonable expenses in connection with the contract or cancelling the contract
- the cost of repairing any property returned to you that has been damaged while in the debtor's possession.

The debtor must return to you any advance and any other property they have received under the contract.

However, if the contract is a credit sale and any of the following apply:

- the debtor has taken possession of the goods, or
- the property was sold by auction, or
- the debtor wants to keep the property, or
- a credit sale was for services that have been performed,

the debtor cannot return the property and must pay the cash price of the property or services (or the balance of the cash price after deducting any amount already paid) to you within 15 working days after notifying you of their decision to cancel the credit contract. In this case, you do not need to return the cash price paid for the property or services, however your obligation to provide the property or services continues.

How must the debtor give notice of cancellation?

The debtor can provide written notice of cancellation in any way that shows their intention to cancel or withdraw from the contract.

They can give you notice, return property, or pay a cash price to you by either giving it to you or posting it.

They can also give you notice in electronic form, if you consent.

An agent acting on behalf of the debtor may provide written notice of cancellation, return property, or pay the cash price.

You are deemed to have received notice of cancellation four days after it was posted, or on the second working day if it was sent electronically.

Situations where right of cancellation does not apply

The right of cancellation does not apply if the credit is provided for a specified period of less than two months and no part of the credit is used, with your knowledge, to pay amounts owing to you or a related company under another credit contract.

A debtor is not entitled to cancel a contract on the grounds that disclosure has not been made to a guarantor.

Statement of right to cancel

When you establish a consumer credit contract with a debtor (see Schedule 1 of the Act), you must disclose a statement of their right to cancel in the following form:

"The Credit Contracts and Consumer Finance Act 2003 gives you a right for a short time after the terms of this contract have been disclosed to you to cancel the contract.

How to cancel

If you want to cancel this contract you must give written notice to the creditor.

***You must also –**

(a) return to the creditor any advance and any other property received by you under the contract (but you cannot do this if you have taken possession of any goods or if you bought any property at an auction or if the contract is for the sale of services that have been performed); or

(b) pay the cash price of the property or services within 15 working days of the day you give notice.

* Delete if the credit contract does not involve a credit sale.

You must also return to the creditor any advance and any other property received by you under the contract.

Delete if the credit contract involved a credit sale.

Time limits for cancellation

If the disclosure documents are handed to you directly you must give notice that you intend to cancel within three working days after you receive the documents.

If the disclosure documents are sent to you by electronic means (for example, e-mail) you must give notice that you intend to cancel within five days after the electronic communication is sent.

If the documents are mailed to you, you must give the notice within seven working days after they were posted.

Saturdays, Sundays, and national public holidays are not counted as working days.

What you have to pay if you cancel

If you cancel the contract the creditor can charge you–

(a) the amount of any reasonable expenses the creditor had to pay in connection with the contract and its cancellation (including legal fees and fees for credit reports, etc); and

*(b) interest for the period from the day you received the property or services until the day you either pay the cash price for the property or services or return the property to the creditor.

* Delete if the credit contract does not involve a credit sale.

#(b) interest for the period from the day you received the advance until the day you repay the advance.

Delete if the credit contract involves a credit sale.

This statement only contains a summary of your rights and obligations in connection with the right to cancel. If there is anything about your rights or obligations under the Credit Contracts and Consumer Finance Act 2003 that you do not understand, if there is a dispute about your rights, or if you think that the creditor is being unreasonable in any way, you should seek legal advice immediately."

INTEREST CHARGES AND FEES

What is an interest charge?

Unlike in traditional credit or tax statutes, "interest" has a very narrow definition.

An "interest charge" **accrues** over time and is derived by **applying a rate** to the unpaid balance under a contract. If these elements are not present, that amount is not an interest charge. It may be a "credit fee".

The annual interest rate is the periodic interest rate you apply, multiplied by the number of periods in a year. If you charge a daily interest rate, the annual interest rate is the rate multiplied by 365 (not 366, even in a leap year). The annual interest rate must be stated in the contract.

What is a credit fee?

Any charge or fee payable by the debtor is a **credit fee** if:

- it is payable as a condition of the contract, or
- it is payable to you in connection with the contract (whether or not as a condition of the contract), or
- it is payable for your benefit in connection with the contract (whether or not as a condition of the contract).

However, it is not a credit fee if the charge is an interest charge, a charge for an optional service, a default charge, or a charge imposed by the government.

Examples

- *You include a charge on every credit contract based on multiplying the advance by 20% (eg, you advance $1,000 and add $200, being $1,000 x 20%, to the unpaid balance). Although this charge is derived by applying a rate to an amount owing, it does not accrue over time. The charge is a credit fee.*
- *You sell goods to a debtor under a credit sale contract specified as "interest-free". The cash price is $1,500 and the payments add up to $1,750. Although the $250 amount accrues over time, it is not derived by applying a rate. The charge is not interest and is a credit fee.*
- *A debtor obtains credit through a broker. The broker charges the debtor $300 for this service. You pay the broker and add the fee to the unpaid balance. This charge is an advance, being "money paid to the order of the debtor".*
- *A debtor obtains credit through a broker. On this occasion you are responsible for paying the broker's charge. You pass on the fee to the debtor. This is a fee payable under the contract to you and is a credit fee.*
- *A debtor obtains credit through a broker. The broker charges $300, which the debtor pays directly. The credit contract makes no reference to it. The fee is payable neither under the contract nor to, or for, your benefit. It is not a credit fee.*

What is an establishment fee?

Establishment fees are commonly referred to as application, booking, documentation and commitment fees. The name of the fee is not important but the function of the fee is.

An establishment fee is any fee or charge relating to your costs in connection with:

- the credit application
- processing and considering the application
- documenting the contract
- advancing the credit.

It does not have to be a single fee, any fee that has one of the above functions is an establishment fee.

A fee relating to taking security for a credit contract, despite not being specifically mentioned in the definition of establishment fee, would be an establishment fee as it relates to processing an application and documenting a contract.

What is a charge for an optional service?

A charge for an optional service relates to a service that, under the contract, the debtor could choose whether or not to accept.

Example

- *A consumer credit insurance policy or extended warranty that the debtor did not have to accept to be provided with the credit.*

A consumer credit insurance policy that the debtor must accept in order to be provided credit is a credit fee.

What are the rules relating to interest charging?

Interest must not be charged in advance. This means that you cannot require payment of interest, or debit any interest charge, at any time before the end of the day to which the interest charge applies.

There are two limited exceptions:

- you can require payment of, or debit, an interest charge in advance if the payment schedule for a contract has a broken first period (a period that is less than the normal period for which interest charges will be debited to the debtor's account)
- you can debit interest on the last day of a multi-day period as long as, when calculating interest, it is not considered part of the unpaid balance on that day.

Example

- *Interest is calculated daily and debited on the last day of every month. The interest charge for the last day may be debited on the same day, as long as it is not included in the unpaid balance for that day.*

Contracts may provide for interest charges to become payable or to be debited at any time after the day to which they apply.

Calculating an interest charge

Section 39 of the Act *(Limit on interest charges)* provides that interest charges must be calculated using one of two alternative methods:

- by multiplying the unpaid balance at the end of the day by the daily interest rate. If there is more than one daily interest rate, the interest rate must be calculated by multiplying each rate to the relevant part of the unpaid balance to which it applies.
- by multiplying a weekly, fortnightly, monthly, quarterly or half-yearly interest rate by the whole or part of the average weekly, fortnightly, monthly, quarterly or half-yearly unpaid daily balance to which it applies.

Interest charges for months, quarters and half-years can be calculated on the basis that all months, quarters and half-years are the same length (by simply dividing the annual interest rate by 12, 4 or 2). However, average daily balances must be calculated on the actual number of days in the period.

Examples

The following examples show how the interest charge is determined using the average daily balances method:

Advance:	*$1000*
Payment frequency:	*monthly*
Annual interest rate:	*16%*

- *Whole period – payment made on time:*
  - *interest charges cover the month of January, ie, 31 days*
  - *unpaid daily balance is $1,000 on each of days 1 to 31*
  - *average unpaid daily balance: $1,000 x 31 = $31,000 ÷ 31 [days] = $1,000*
  - *interest charges for January: (annual interest rate (16%) ÷ 12) x $1000 =1.33% x $1,000 = $13.30.*
- *Part period – part prepayment made during period:*
  - *interest charges cover the month of January, ie, 31 days*
  - *extra payment of $250 made during period on 16 January*
  - *unpaid daily balance $1,000 on each of days 1 to 15*
  - *unpaid daily balance of $750 on each of days 16 to 31*
  - *average daily unpaid balance: ($1,000 x 15) + ($750 x 16) = $27,000 ÷ 31 [days] = $870.97*
  - *interest charges for January: (annual interest rate16% ÷ 12) x $870.97 = 1.33% x $870.97 = $11.58.*
- *Part period – full prepayment made during period:*
  - *interest charges cover the first 15 days of January – the loan is repaid in full on 16 January*
  - *the unpaid daily balance on each of days 1 to 15 is $1,000*

- *average unpaid daily balance: $1,000 x 15 = $15,000 ÷ 31 [days] = $483.87*
- *interest charges for January: (annual interest rate16% ÷ 12) x $483.87 = 1.33% x $483.87 = $6.43.*

What are default interest charges and default fees?

"Default interest charges" are charges that are payable on breach of a contract. The definition of an interest charge is also relevant, so default interest charges must be determined by applying a rate and must accrue over time.

"Default fees" are payable by a debtor if they breach the contract. They include fees payable if you enforce the contract, eg, repossession fees.

Rules for default interest charges

You are not permitted to structure the contract in such a way that the interest rate stated is reduced if the debtor makes the payment on time.

However, the contract may provide for a default interest rate if the higher rate is imposed only where:

- there has been a default in payment, and while the default continues, or
- a debtor exceeds the credit limit under the contract and while the credit limit is exceeded. When you apply a default rate, you must make sure it reflects a genuine estimate of the loss caused by the default. A default rate may be struck down if a Court considers it to be oppressive. Oppressive practices may incur Court-imposed penalties.

You should only apply a default rate to the amount in arrears. Applying it to the entire unpaid balance, including amounts not overdue, would exceed a genuine estimate of the loss caused by default and as such would be oppressive.

What are the rules for credit fees?

The Act does not attempt to prescribe the amount or nature of credit fees that may be charged to the debtor. However, a credit fee must not be unreasonable. The Court may annul or reduce a fee that is found to be unreasonable.

When is a fee unreasonable?

The basic rule with all fees is that they must directly relate to costs incurred by you. A fee will be unreasonable if it does not relate to an actual cost you have incurred. Some fees may represent the average cost for specific matters in relation to a class of contracts.

Fees which accrue over time and appear to be in the nature of an interest charge, without meeting the definition of interest (eg, a fee based on the difference between the sum of instalments in a credit sale and the cash price of the goods), are likely to be unreasonable. In such a case it is unlikely they relate to a specific cost incurred by the creditor.

Establishment fees

Establishment fees should be equal to, or less than, your reasonable costs in connection with the credit application, processing and considering the application, documenting the contract and advancing the credit. You could also charge an establishment fee for the average costs of those matters across an appropriate class of credit contract.

Examples

Practices considered unreasonable include:

- *loading the establishment fee with additional up-front interest charges*
- *increasing the amount of a trade-in allowance while also increasing the establishment fee*
- *charging a fee based on a percentage of the advance, eg, you charge 1% of the amount advanced as an establishment fee. As the cost of establishing the contract does not vary according to the amount advanced, the establishment fee of a high-value loan is likely to be higher than the cost of establishing the contract.*

Prepayment fees

Fees or charges on part and full prepayments are considered unreasonable if they exceed a reasonable estimate of your loss arising from the part or full prepayment, including administration costs. See *Full prepayment* on page 20 for more information.

Note: You cannot charge a fee representing the average loss arising from a prepayment. Prepayment fees must be specific to the credit contract concerned.

Other credit and default fees

In determining whether a credit or default fee is unreasonable, under Section 44 of the Act *(Other credit fees and default fee)*, the Court must consider whether the fee reasonably compensates you for any costs you incur, or is a reasonable estimate of any loss incurred by you as a result of the debtor's acts or omissions. The Court also must have regard to reasonable standards of commercial practice.

As with establishment fees, you must ensure that the fees provided relate to the costs incurred. The fee should do no more than compensate you for that cost.

Some fees will not relate directly to your costs, eg, you may pay a brokerage or other third party fee on behalf of a debtor. You should not add a margin to such a fee. However, a separate fee can only be charged if it is no more than the reasonable administrative cost of making the payment to the broker on the debtor's behalf.

Fees or charges passed on by a creditor

Section 45 *(Fees or charges passed on by a creditor)* provides that a fee or charge payable by a debtor for an amount payable, or to reimburse an amount paid by you to a third party, must not exceed the **actual amount** payable by you.

This **actual amount** must be determined by taking into account any discount, rebate or allowance you receive. For example, if you receive a discount for using a particular lender's mortgage insurance provider, the amount passed onto the borrower for the insurance must include the discount and not be the full price. Other fees covered by Section 45 include lenders' mortgage insurance, security registration fees, valuation fees, and fees payable to credit reference agencies.

Fees that would not fall under Section 45 include consumer credit or other insurance or warranty products, brokerage fees when the broker acts as an agent for the debtor, and lawyers fees for services to the debtor. However, Section 44, *Other credit fees and default fee,* would apply.

This is because such fees are payable by the **debtor** and are not a fee paid by you to a third party. Also, such fees are normally charges for optional services, which are not credit fees and not subject to the same rules. While Section 45(4) provides that you may receive commissions in connection with consumer credit insurance, this is only for avoiding doubt.

Note: If you charge a single establishment fee that covers the costs of payments to third parties, you do not need to disclose those amounts separately.

Can I charge for my costs in connection with charges paid to third parties?

Yes. If you can quantify the cost to you associated with paying an amount to a third party you can make a reasonable separate charge representing that cost. Provision to make such charges must be included in the contract and disclosed in the initial disclosure statement.

What happens if I debit an interest charge or fee in contravention of the act?

You may be liable for various penalties that will be outlined in a later publication to be produced by the Commerce Commission. The Court may also order that the charge is reduced or annulled and you will be required to refund the amount improperly charged to the debtor.

PAYMENTS

What are the rules for payments?

The ordinary rule is that debtor payments must be credited to the debtors' accounts as soon as practicable after they are received.

Section 47 allows payments to be credited on the day they were received rather than the day they were processed, eg, if a debtor makes a payment on a non-business day and the payment is processed on a later business day, it may be credited to the debtor's account on the day it was made.

Exception

This ordinary rule is subject to the following exception.

If a credit contract specifies a payment schedule, payments may be credited according to the schedule, rather than as soon as is practicable. It is only applicable to instalment credit contracts.

A payment schedule is not defined in the Act but means a plan for the receiving and crediting of payments. This involves specifying the timing and amount of each payment, such as its due date and specifying that payments will be credited according to the schedule. As a result, you can credit the payments on the date specified in the schedule rather than when they were received.

This will allow you to estimate the total interest charge on a contract with some certainty.

Examples

- *A contract provides that payments are due and will be credited on the 20th of each month. If a debtor makes a payment on the 15th, you may credit the payment on the 20th.*
- *A contract provides that payments of $90 are due at the end of each fortnight. A debtor makes a payment of $95. The debtor may credit $90 when it is due and $5 towards the following fortnight's payment.*

What about part prepayments?

If a debtor offers a part prepayment you must receive and credit it as soon as practicable, unless the credit contract specifies otherwise.

You can refuse to receive part prepayments if this is specified in the contract. If you refuse the payment, it must be returned or refunded to the debtor. If the contract specifies a payment schedule you may credit the part prepayment in accordance with the schedule, provided that this is authorised in the contract.

You may charge a fee for part prepayment, based on a reasonable estimate of your loss resulting from the payment.

What is full prepayment?

"Full prepayment" is payment of the unpaid balance in full before it is due under the contract. This is often referred to as "early settlement".

Do I have to accept a full prepayment from a debtor?

Yes, the debtor has a right to make full prepayment any time. You cannot remove that right by contract.

What must the debtor pay to make full prepayment?

The debtor must pay:

- the unpaid balance as calculated at the time of the full prepayment. In calculating this, you must make sure you only include interest charges that have accrued to the date of full prepayment. You must also not debit any fees that would otherwise be payable after the full prepayment, eg, you cannot "bring forward" any monthly account keeping fees
- any fees that cover your administrative costs. These credit fees must be authorised by the credit contract and disclosed in the initial disclosure statement
- a fee or charge that does not exceed a reasonable estimate of your loss arising from the full prepayment. This must be authorised by the contract and disclosed in the initial disclosure statement.

You must also provide a proportionate rebate of any consumer credit insurance premium financed under the credit contract. This is discussed in *Credit-related insurance* (on page 24).

What is meant by a fee or charge that does not exceed a reasonable estimate of my loss?

"Loss" in this context is based on the principles of contractual damages. It includes the gains you would have made if the contract had run its course and the debtor had not made full prepayment.

Calculating your loss involves comparing the return that you would have made on the original contract with the return that you will make when the prepaid amount is re-advanced to another debtor.

A fee that covers a reasonable estimate of your loss is a fee that compensates you for this foregone return.

The principles of contractual damages provide you with a duty to mitigate the loss. This means you must make reasonable efforts to re-advance the amount prepaid.

How do I calculate a reasonable estimate of my loss?

You may use the formula specified in regulations made under Section 54 *(Creditor's loss arising from full prepayment)* of the Act. This provides a "safe harbour" for creditors. If you apply the formula correctly, you can be assured that the amount calculated represents a reasonable estimate of your loss.

You may use any other formula provided that its application does not produce a sum that is greater than a reasonable estimate of your loss.

How does the formula work?

The formula is based on the positive difference between the present value of remaining payments due on the loan, and the present value of the payments that would be received (if the amount paid early was re-lent under a hypothetical replacement contract for the remaining term at your prevailing interest rate).

The interest rate to be used for the replacement contract is the prevailing rate at which you would make an advance for the outstanding amount for a period equal to the remaining term (or the closest term you offer) of the original contract.

Obviously, you will have only suffered a loss if your prevailing interest rate has dropped since you entered into the original contract.

Note: This formula will be fully set out in regulations. It will be explained in a future publication to be produced by the Commerce Commission.

Will the formula apply in all cases?

The formula has been designed for fixed instalment contracts having regular, equal payments. The formula will not apply to contracts that have atypical features, eg, unequal sized payments. Nevertheless, the principles underlying the formula can be adapted for other circumstances.

Some other points to note on calculating loss

The formula assumes a fixed interest rate on the credit contract. If the contract has a variable interest rate, the rate applying to the original contract at the time of the full prepayment will be your prevailing rate so no issue of "loss" arises.

Similarly, you will not suffer a loss with revolving credit contracts, which are designed to be repaid at any time.

It is assumed you are able to re-advance the credit on the day it is prepaid. It would not be appropriate for you to include in the loss calculation any assumption that it takes longer than this. Firstly, as mentioned above, you must mitigate your loss by making reasonable efforts to re-advance the money as soon as it is prepaid. Secondly, at the time of the prepayment it is not known how long it will take to re-advance the money.

HARDSHIP APPLICATIONS

The Act provides debtors with a right to apply for changes to a contract on the basis of unforeseen hardship.

What is unforeseen hardship?

"Unforeseen hardship" means an event such as illness, injury, loss of employment or the end of a relationship that causes the debtor to be unable to meet their obligations under a credit contract in the short term.

What is a hardship application?

A debtor in this situation can apply for changes to the credit contract.

They apply to you in the first instance – if you refuse, they can apply to the Court.

What changes can the debtor apply for?

The only changes that debtors can apply for under a hardship application are:

- extending the contract term and reducing the amount of each payment due under the contract
- postponing the dates on which payments are due
- extending the contract term and postponing payments.

They may not seek changes to reduce the annual interest rate or the unpaid balance under the contract.

The changes are to give the debtor short-term relief so they can meet their contract obligations in the long term. They may not seek any changes to the contract that are more extensive than necessary for this purpose.

The debtor's statutory right to apply for a hardship variation does not limit any changes that may be made by agreement between the creditor and the debtor.

When can the debtor not apply?

The debtor must show that they have suffered unforeseen hardship. They cannot apply if:

- they are currently in default on a payment (the payments must be up to date)
- they have exceeded a credit limit
- the hardship was foreseeable at the time they entered the contract (eg, if a debtor sustained an injury before entering the contract).

What is a consumer lease?

A "consumer lease" is a contract for hire where the lessee has a right to buy the goods, or the lease is for more than one year.

To be a consumer lease that is regulated under the Act:

- the lessee must be a natural person
- the lessee must enter the lease primarily for personal, domestic or household purposes
- the lessor must be in the business of leasing goods or make a practice of leasing goods in the course of a business.

The following rules also apply:

- a combination of contracts that, in substance, creates a lease is to be treated as a consumer lease, even if no contract in itself creates a consumer lease
- a lessor may take a declaration from a lessee that the goods are hired primarily for personal, domestic or household purposes (the same rules apply as with declarations for credit contracts).

What are the lessor's obligations?

The lessor's obligations are similar to those applying to credit contracts.

Initial disclosure

If you are a lessor, you must disclose as much of the following information that applies before the contract is made or within five working days:

- your full name and address
- the fact that the lease is a consumer lease under the Act
- the term of the lease
- the cash price of the goods leased
- whether the lessee has an option to buy the goods and, if so, the option price or how it is calculated
- the amount, timing and number of payments to be made under the contract
- any amount, such as a deposit, paid before the lease commences
- the total amount payable by the lessee under the lease
- a statement of the conditions upon which the lessee can terminate the lease
- services financed under the lease
- default fees payable upon breach of the contract
- any other items prescribed by regulation.

You must also disclose any other terms of the lease within five working days of making the lease, and, if you arrange it, the terms of any credit-related insurance policy taken out in connection with the lease.

Variation disclosure

Any changes to a lease agreed by the parties must be disclosed to the lessee before they take effect.

Changes that reduce the lessee's obligations do **not** have to be disclosed.

Request disclosure

A lessee may ask for information on:

- the amount, timing and number of payments to be made under the lease
- full particulars on any change made to the contract
- a copy of any disclosure statements made or that should have been made.

Termination

Lessees have no right to terminate a lease before the end of its term. However, if a lease is terminated, the amount they pay must not exceed a reasonable estimate of your loss caused by termination.

Note: Regulations may be made to prescribe a procedure for calculating the loss. At the time of publication no regulations have been made.

What is credit-related insurance?

The Act defines credit-related insurance as:

- insurance over goods used as security
- "gap insurance", ie, cover for the gap between the amount an insurance policy pays out if secured goods are destroyed, and the amount outstanding under the credit contract
- consumer credit insurance, ie, cover for the outstanding obligations of a debtor under a credit contract in the event of their injury, sickness or death.

Credit-related insurance is insurance taken out by the debtor. Insurance that protects you, eg, lender's mortgage insurance, is not consumer credit insurance.

What is a repayment waiver or an extended warranty?

"Repayment waivers" and "extended warranties" are forms of creditor "self-insurance".

A repayment waiver is an agreement between the debtor and you in which you, for an additional payment from the debtor, agree to waive any amount due in the event of their sickness, injury or unemployment.

An extended warranty is an agreement between the debtor and you in which you agree to repair or replace defective goods outside the normal warranty period.

These agreements are treated like other forms of credit-related insurance. The rules below apply to repayment waivers and extended warranties as well as to credit-related insurance.

What are creditor obligations for credit-related insurance, extended warranties and repayment waivers?

The Act specifies three obligations for credit-related insurance:

- under Section 69 a creditor or lessor must not make any unreasonable requirement in relation to the terms on which a debtor or lessee takes out credit-related insurance
- under Section 70 the creditor or lessor must disclose the terms of the credit-related insurance contract if they arranged the insurance. See the sections on initial disclosure for consumer credit contracts and consumer leases (pages 6 and 23)
- under Sections 51 and 52, if the debtor makes full prepayment, the creditor must provide a proportionate rebate of any consumer credit insurance premium financed under a consumer credit contract.

When are credit related insurance requirements "unreasonable"?

A requirement is unreasonable if it is not reasonably necessary for protecting the lessor's or creditor's legitimate interests, or is not necessary in light of the risks undertaken by the parties to the arrangement.

Example

- *Requiring a debtor to take out insurance for a risk that does not exist, such as requiring a beneficiary to cover loss of employment.*

If a requirement is found to be unreasonable, the Court may order that the insurance policy be annulled and the cost of the policy refunded to the debtor or lessee by the creditor.

How do I calculate a proportionate rebate of an insurance premium in the event of full prepayment?

If you have arranged a consumer credit insurance policy for a credit contract and the debtor makes full prepayment, you must provide a proportionate rebate of the policy premiums.

This rebate must be calculated at the time the full prepayment is made.

The procedure for calculating the rebate will be provided in regulations.

REOPENING OPPRESSIVE CREDIT CONTRACTS

Law has not changed

The provisions relating to reopening oppressive contracts have been carried over from the Credit Contracts Act. However, the provisions are now enforceable by the Commerce Commission.

The only changes relate to updating the terminology and, in Section 98 *(Interim injunction)*, increasing the time limit for making applications – from six months since the last obligation was performed, to one year.

Definition of oppressive

For the purposes of the Act, "oppressive" means oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice.

Remedies

The Court may reopen oppressive credit contracts, consumer leases and buy-back transactions.

The Court may:

- order that an account be taken for any transaction
- allow any party to possess the whole or part of any property that is the subject of the credit contract, consumer lease or buy-back transaction
- direct any party to pay to any other party any sum that the Court thinks fit
- order that any obligation outstanding under the contract be extinguished, revised, altered, complied with, or performed
- order that the contract, or any term of the contract, or any security interest in connection with the contract be revised or altered
- if a party has parted with any property that is the subject of a security interest, order them to indemnify the other party or parties
- direct any party to do or refrain from doing any act or thing in relation to any other party.

TRANSITIONAL PROVISIONS

The Act applies to every credit contract, consumer lease, and guarantee made after the Act takes effect on 1 April 2005.

Contracts formed before this date will be governed by the law in force at the time.

You can choose to bring contracts formed before 1 April 2005 (governed by the Credit Contracts Act 1981 and Hire Purchase Act 1971) under the Act. You do not need the debtor's consent to do this, but in doing so you must **not** increase any obligation they have in connection with the contract.

KEY CHANGES IN THE ACT

Key change	What the change means	Act reference
Definition of consumer credit contract	• A debtor must be a natural person. • The contract must be entered into primarily for personal, domestic or household purposes. • Interest charges, credit fees or a security interest must apply. • All consumer credit contracts are covered, regardless of the total amount of credit outstanding. • Borrowings primarily for investment purposes are not covered. Creditors may get a declaration from borrowers that the credit is for business or investment. If the lender has reason to believe the loan was really for consumer purposes, the declaration is ineffective.	Part 2 Subpart 1
Disclosure requirements	• Disclosure must be clear, concise and likely to bring the information to the attention of a reasonable person – they must not be misleading. • The Act provides for model disclosure statements set out in regulations. Although not compulsory, using the model disclosure statements will ensure that creditors have met their requirements under the Act. • Initial disclosure requirements may be contained in the credit contract or lease – including information such as the creditor's full name and address, the initial unpaid balance, the credit limit, the method of charging interest, the interest free period if there is one, credit fees and charges, and the payments required. • There is an obligation for ongoing disclosure – continuing disclosure statements are required every 45 days for revolving credit contracts and at least every six months for all other credit contracts. • The Act makes some changes to the timing of disclosure, with various deadlines: - for making disclosure when the contract is first signed - to guarantors - when the interest rate changes - when the parties agree to changes - when the lender has the right to make unilateral changes. • Additional disclosure must be made on variation of the credit contract or lease, or when requested by the debtor.	Part 2 Subpart 2

	• Allows for electronic disclosure if consented to by the debtor. • Creditors not making proper disclosure cannot enforce contracts against debtors who fail to pay until they make correct disclosure. • Debtors can also seek statutory damages from creditors for the failure to comply.	
Interest charges and fees	• Regulates how interest is to be calculated. • Requires fees to be "reasonable" (the fee should be matched to a cost incurred by the creditor). • When a fee is payable by a creditor to a third party and passed on to the debtor, it should match the specific costs incurred by the creditor. • Finance rate not required.	Part 2 Subpart 5 Subpart 6
Prepayment	• Regulates how prepayment is to be calculated. • A creditor must accept a full prepayment, and may only refuse part prepayments if allowed in the contract.	Part 2 Subpart 7
Hardship provisions	• Debtors have the right to request a variation of a credit contract if unforeseen circumstances cause hardship, eg, illness, injury, loss of employment or the end of a relationship. • The debtor can ask to extend the contract by reducing the amount of each payment or postponing payments, without incurring penalties. • A debtor cannot seek a hardship variation if they are in default on the credit contract. • A debtor can appeal to the Courts if a lender refuses their request.	Part 2 Subpart 8

KEY TERMS

This list sets out the key terms referred to throughout this publication, and provides definitions as specified in the Act.

Advance An advance describes the value provided by the creditor to the debtor. It means any of the following:

- money paid to the debtor or to a person specified by the debtor
- any debt consolidation paid for by you on the debtor's behalf
- the cash price of any goods or services purchased by the debtor from you
- the value of a cash advance or a purchase made on a credit card.

Annual interest rate A rate applied to the unpaid balance to derive the interest charge, expressed as an annual percentage.

Broker A person who in return for payment by either the debtor or the creditor assists a person in obtaining credit.

Cash price The lowest price at which a person is able to purchase property or services based on payment in full from the seller at the time the contract is made. Any "discount for cash" must be factored into the cash price. Where the creditor or lessor does not sell goods for cash, the cash price is the fair market value of those goods.

Credit sale A sale or provision of services in which payment of the whole or part of a purchase price is deferred to a later date, eg, a sale by instalments, hire purchase, or conditional sale will be a credit sale.

Creditor A person who provides credit under a credit contract. If the credit contract is assigned, the party receiving the assignment is also the creditor.

Daily interest rate The rate determined by dividing the annual interest rate by 365.

Guarantor A person who:

- guarantees the performance of a debtor's obligations under a contract, or
- indemnifies a creditor against any loss they may incur in connection with the contract, or
- assumes liability for performing the obligations of a debtor under a contract.

Payment In relation to a credit sale, includes a deposit or trade-in allowance.

Revolving credit contract A credit contract that anticipates multiple advances that are made when requested by the debtor. The contract does not limit the total amount that is advanced to you over the life of the contract. The definition includes "charge cards" that require the full outstanding balance to be paid at the end of each billing period.

Security interest An interest in property created by a transaction that secures payment or performance of an obligation under a credit contract or consumer lease. Note that the definition includes land as well as personal property.

Unpaid balance The amount owing under a credit contract at a particular time. The unpaid balance is the total of all debits minus all credits under the contract.

Unpaid daily balance The unpaid balance under a credit contract at the end of a particular day.

Working day Any day other than:
- Saturday and Sunday
- Waitangi Day
- Good Friday
- Easter Monday
- Anzac Day
- Queen's Birthday
- Labour Day
- the period between 25 December and 2 January.

FOR MORE INFORMATION

Ministry of Consumer Affairs

Website: www.consumeraffairs.govt.nz

Publications for Business

Business Note – Hire Purchase – A Guide for Retailers (Please note this publication will be updated prior to the Act taking effect.)

Publications for Consumers

Factsheet – Home Buy-back Schemes

Commerce Commission

Website: www.comcom.govt.nz

LEGISLATION

Copies of the Acts mentioned in this publication can be accessed online, for free, at www.legislation.govt.nz.

Printed copies are sold by Bennetts Bookshops and some Whitcoulls stores.

Bennetts Bookshop in Wellington carries all legislation and provides a mail service throughout the country.

Contact Bennetts Bookshop by phone, 04 499 3433, or by fax, 04 499 3375.

BUSINESS NOTES

Ministry of Consumer Affairs
PO Box 1473
Wellington
New Zealand
Phone: 64 (4) 474 2750
Fax: 64 (4) 473 9400
Email: mcainfo@mca.govt.nz
Website: www.consumeraffairs.govt.nz

ISBN 0-478-26380-5

June 2004

The purpose of this *Business Note* is to provide a general explanation on the law relating to credit contracts and consumer finance. It is not intended as a source of specialist legal advice. You may wish to contact a lawyer for further advice. The Ministry does not accept any responsibility for the manner in which this information is interpreted or for the consequences of relying on it.

MINISTRY OF CONSUMER AFFAIRS
MANATŪ KAIHOKOHOKO