CONSUMER CREDIT LAW REVIEW

PART 4: OVERINDEBTEDNESS, INSURANCE AND E-CREDIT

August 2000

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CONTENTS

1. INTRODUCTION 1

2. CALL FOR SUBMISSIONS 2

Final date for submissions and contact details 2

OFFICIAL INFORMATION ACT 1982 3

PRIVACY ACT 1993 3

3. OVERINDEBTEDNESS 4

3.1 The nature of consumer debt 5
3.1.1 Credit which consumers cannot repay 5
3.1.2 Changing circumstances 5
3.1.3 Guarantors 6

3.2 Policy response 6

3.3 Allowing contracts to be varied in cases of hardship 7
3.3.1 Advantages 7
3.3.2 Disadvantages 8
3.3.3 Additional issues 8

3.4 Reopening guidelines: allowing transactions to be reopened if lenders have not appropriately ascertained the ability of consumers to repay 8
3.4.1 Advantages 9
3.4.2 Disadvantages 10

3.5 Requiring lenders to undertake a "proper" budgeting process 10
3.5.1 Advantages 10
3.5.2 Disadvantages 11

3.6 The wider picture 11
3.6.1 Education and dissemination of information 11
3.6.2 Support for community agencies 12

4. CREDIT-RELATED INSURANCE 13

4.1 The benefits of credit-related insurance 13

4.2 Problems with credit-related insurance 14
4.2.1 Excessive premiums 14
4.2.2 Policies not fully disclosed 15
4.2.3 Inappropriate insurance cover 16
4.2.4 Duplicate insurance cover 16

4.3 Policy response 16

4.4 Defining credit-related insurance 16
4.4.1 Extended warranty contracts 16
4.4.2 Repayment waivers 17

4.5 Should the lender have the right to require insurance? 17
4.5.1 Consumer credit insurance (CCI) 18
4.5.2 Life insurance 19
4.5.3 Lender's mortgage insurance 19
4.5.4 Insurance of secured goods 19

4.6 Should the lender have the right to both require insurance and choose the insurer? 20
4.6.1 Additional issues 21

4.7 Disclosure of policy 22
4.7.1 Additional issues 22

4.8 A reconsideration ("cooling-off") period for credit-related insurance 23

4.9 Requiring insurance to be appropriate 23
4.9.1 Restriction on commissions 24

5. CREDIT CONTRACTS VIA THE INTERNET 25

5.1 Effect of current legislative requirements on e-credit 25
5.1.2 Credit Contracts Act 1981 25
5.1.3 Hire Purchase Act 1971 25
5.1.4 Credit (Repossession) Act 1997 26
5.1.5 Other requirements 26
5.1.6 Conclusion 26

5.2 Implications of the proposed Electronic Transactions Bill 26
5.2.1 The principles behind the recognition of e-transactions 27

5.3 Policy response 27
5.3.1 The reliability of electronic communications 28
5.3.2 Date of commencement of a contract 29
5.3.3 Verification of the sender 30
5.3.4 Confirmation of consent to purchase credit 30
5.3.5 Form and presentation of information 31
5.3.6 Storage and reproduction of documents 32

5.4 Cross-border consumer credit 32

APPENDIX ONE Current regulation of credit-related insurance 34

APPENDIX TWO Insurance provisions in Australian Consumer Credit Code 36

1. INTRODUCTION

This document is the fourth public consultation document in the Consumer Credit Law Review. It deals with three important topics: each raises issues on which the Ministry seeks comment.

Each topic is discussed in a separate chapter. The topics are:
- Overindebtedness
- Credit-related insurance
- Credit contracts over the Internet.

2. CALL FOR SUBMISSIONS

The Ministry encourages written submissions from interested parties on the content of this document. The purpose of the submissions will be to inform the Ministry as it proceeds with the Consumer Credit Law Review. Ultimately, the submissions will inform the government on any decisions it chooses to make with respect to the reform of consumer credit law.

Issues for Discussion

The Ministry welcomes your views on the content and proposals of this consultation document.

There are specific questions contained in the text.

Final date for submissions and contact details

Final date for receipt of submissions is Friday 1 December 2000.

Comments and submissions should be addressed to:

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OFFICIAL INFORMATION ACT 1982

In providing your submission, please advise us if you have any objections to the release of your submission. If this is the case, please advise us of the parts of your submission that you would wish withheld, and the grounds for withholding. In preparing and releasing any summary, and in considering any formal Official Information Act requests that might be received, the Ministry will carefully review any representations that you make in this regard.

PRIVACY ACT 1993

Any personal information that you supply to the Ministry in the course of making a submission will be used by the Ministry in conjunction with consideration of matters covered by this consultation paper only.

When preparing any summary of submissions for public circulation, it is the Ministry's usual practice to set out the names of parties making submissions. Your name will be included in any such summary unless you inform the Ministry that you do not wish your name to be included. In order to indicate your wishes, or to view personal information held about you in respect of the matters covered by this discussion paper, or to request correction of that information, please contact the Ministry of Consumer Affairs, ph (04) 474 2750.

3. OVERINDEBTEDNESS

Overindebtedness occurs when borrowers find themselves with a higher level of debt than they can service.

There are some indications which suggest that levels of consumer debt are increasing, and that this is resulting in overindebtedness:

- Surveys conducted by the Reserve Bank of New Zealand have demonstrated trends toward rising personal indebtedness. For instance, from 1978 to 1987 household debt remained below 50 percent of personal disposable income, but climbed steadily to exceed 100 percent level by 1997.[1] The survey shows that most forms of consumer borrowing have significantly increased in that time, particularly from the major trading banks.

- New Zealand's network of Budget Advisory Services reports that more people are requiring its services. In the twelve months to June 1999, it reported that the number of people applying for budgeting help rose from 70,500 to 91,700, and that the total amount owed by its clients rose from $43.7million to $56.4million. (In part, however, this may be due to increased consumer awareness of the Budget Advisory Service.)

- In the first six months of 1999, the credit-check agency Baycorp reported that 22.8 percent of a sample of people on its credit file had an "adverse credit record". The figure for the same survey for the first six months of 1998 was 19.7 percent.

- Increasing numbers of consumers are filing for bankruptcy. In the year to the end of June 1998, consumer bankruptcies[2] rose by 42 percent to 1,844. In the year ended June 1999, they rose again slightly, to 1,945. The number of consumer bankruptcies in comparable countries has also steadily increased. For example, in Australia, the consumer insolvency rate more than doubled between 1986/87 and 1996/97; and in Canada the number of consumer bankruptcies also rose considerably in the 1990s.[3]

Overindebtedness causes financial distress and ultimately can lead to bankruptcy. The consumer, or one of their creditors, can petition for bankruptcy if the consumer is totally unable to repay their debts. Bankruptcy, however, has serious consequences for both the consumer and the lender – and it is a situation that both parties have good reason to avoid.

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[1] C Thorp and B Ung "Trends in household assets and liabilities since 1978" (2000). *Reserve Bank of New Zealand: Bulletin* Vol. 63 No. 2, p 17. The survey does not include small lending institutions such as cash-loan companies as the amount of money lent or taken as deposits is trivial in this context.

[2] The term "consumer bankrupt" denotes a bankrupt whose debts are of a domestic nature.

[3] In 1986/87 the Australian consumer-insolvency rate was 0.5 per 1,000 of the population. By 1996/97 it was 1.2 per 1,000 of the population (quoted from T Caddock (1998). *Comparative Macro Statistical Overview of Bankruptcy Rates in North America and Selected Overseas Countries,* Office of the Superintendent of Bankruptcy Industry, Canada p 24).

3.1 The nature of consumer debt

Personal overindebtedness is typically caused by one of the following:

- a consumer has received credit which they were always unlikely to be able to repay
- a consumer becomes unable to meet repayments because of changing circumstances – for example job loss, separation, or illness
- a consumer agrees to act as a guarantor without understanding the full nature of the obligations incurred and later finds that they are responsible for repaying the debt.

3.1.1 Credit which consumers cannot repay

For a variety of reasons – such as desperate need, or not understanding the full extent of what they are committing themselves to[4] – some consumers obtain credit when, rationally, there is no likelihood they can repay it within the prescribed term.

This raises the question of whether lenders sometimes deliberately lend to consumers who have little prospect of repaying the full amount of their debt. The argument is often made that lenders may “overlend” if, in the event of default, they have sufficient security, or a guarantor, to cover the debt. Credit may also be arranged by a retail seller (not by the lender directly) who fails to properly assess the credit rating of the consumer, being more concerned to sell the merchandise.

Lenders dispute that there is an incentive to overlend: they claim it is irrational to overlend, that there are significant transaction costs in realising security, and that (apart from loans secured against real property) the value of security is rarely enough to cover the debt and the lender’s enforcement expenses. If the outstanding debt and the enforcement expenses are not recovered through the security, the lender will be obliged to recover this cost through its interest rate, placing it at a competitive disadvantage.

3.1.2 Changing circumstances

Consumers can find themselves in circumstances which were not anticipated when credit was obtained. This can occur through illness, job loss, or the breakdown of a relationship. Alternatively, an anticipated event may not occur, for example a pay increase or a legacy may not eventuate.

Circumstances such as job loss and illness can be insured against – but even if insurance is taken out, the terms of the policy may not sufficiently cover the debt. For example, the circumstances of a consumer’s job loss may not meet the requirements of the policy, or an exclusion in the policy may mean that a claim made by a consumer is rejected.

[4] This applies particularly to contingencies such as default.

3.1.3 Guarantors

There is also the risk that a guarantor – a consumer who guarantees repayment of the debt on behalf of a borrower – could end up suffering the consequences of overindebtedness. This can occur if the person who borrowed the money defaults and the guarantor is called on to honour repayments.

Some guarantors have neither appreciation of the obligation that they have undertaken by agreeing to guarantee a loan, nor ever expect to have to fulfil the guarantee.

In some instances, the guarantor is under psychological pressure from a partner or relative to guarantee the loan. Similar pressure may result in a partner becoming a "joint signatory" to the loan, even though the loan is not for their use. In the event of default by the principal debtor, the co-signatory may have the debt enforced against them. Because the co-signatory is usually the partner of the principal debtor, this is often referred to as "sexually transmitted debt" or "relationship debt".

The Credit Contracts Amendment Act 1998 aims to alleviate some of these problems, by requiring lenders to disclose the cost of credit to guarantors. This may influence some consumers in their decision whether or not to guarantee a loan. However, since it only came into effect on 1 March 1999 it is premature to evaluate its effectiveness.

3.2 Policy response

This section examines provisions that could be included in consumer credit legislation as an attempt to deal with overindebtedness.

The Ministry of Consumer Affairs believes consumer credit legislation has only a limited role in preventing overindebtedness. Borrowing money is a widespread and legitimate activity in a consumer society. Without credit, numerous transactions of benefit to both businesses and consumers would not occur. Inevitably, however, if consumers continue to borrow, some of them will become overindebted. We do, however, touch on some broader considerations for dealing with overindebtedness in the final part of this chapter.

Within the confines of consumer credit law, extending and improving "disclosure" requirements[5] should help more consumers to understand their obligations when signing up for a consumer credit transaction. In turn, understanding their obligations should generally discourage consumers from taking out credit if they know they are unlikely to be able to meet the repayments.

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[5] See Ministry of Consumer Affairs, (April, 2000). *Consumer Credit Law Review, Part 3, Transparency in Consumer Credit: Interest, Fees and Disclosure*.

Further options include:

- allowing contracts to be varied in cases of hardship
- allowing transactions to be reopened in cases where lenders do not appropriately ascertain the ability of consumers to repay
- requiring lenders to do a budgeting exercise with borrowers before extending credit.

At the margin, such measures may have some impact on the credit market, measured in terms of aggregate funds loaned and the cost of credit. It is unlikely, however, that the overall impact would be material.

3.3 Allowing contracts to be varied in cases of hardship

In Australia, section 66(1) of the Consumer Credit Code[6] allows a consumer to apply to the lender to change the terms of the contract, if they are unable to meet their obligations because of illness, unemployment or another reasonable cause. There must also be a reasonable expectation that the obligations can and will be discharged if the contract is restructured.

If the lender refuses, the borrower has the right to apply to the Court for a variation.

Section 66(1) does not restrict the right of the parties to negotiate, or to agree to vary the contract. What it does do, (in addition to the above) is to provide the grounds for a Court application in cases where the parties are unable to agree on appropriate changes.

Section 66(2) sets out the changes that may be agreed upon. A change may be sought to extend the period of the contract (and therefore reduce the amount of each repayment), or to postpone the due dates on which repayments are required.[7] A lender may agree to both.

3.3.1 Advantages

A “hardship” provision would provide a further incentive for lenders to negotiate a variation to the contract when consumers get into genuine difficulties, rather than putting consumers into default or implementing enforcement proceedings. Negotiating revised arrangements for payment is easier than terminating and enforcing a contract.

It would also encourage consumers to approach their lender when they face repayment difficulties, rather than trying to ignore the issue because of fear that the lender might take immediate action to recover the debt. A “hardship” provision in statute may increase the likelihood of consumers becoming aware of and understanding this right.

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[6] The Code became law in all Australian states in November 1996.

[7] Section 66(2) does not require a change to the interest rate. The outstanding balance would continue to accrue interest charges.

Such a provision may be successful in preventing some consumers from becoming severely overindebted and incurring consequential financial distress.

3.3.2 Disadvantages

The inclusion of a "hardship" provision in consumer credit legislation would inconvenience those lenders who would prefer to exercise their right to enforce the contract immediately if consumers are likely to default.

The provision may be used opportunistically by borrowers in response to enforcement actions by lenders – and would need to be carefully drafted to minimise this.

3.3.3 Additional issues

If legislation were to include a "hardship" provision, then consideration needs to be given to whether or not a *monetary limit* should be applied. In Australia, the hardship provision outlined above applies only to contracts up to A$125,000 – unless otherwise prescribed by regulation.[8]

Should a "hardship provision" be enacted in New Zealand consumer credit legislation?
If so, is it necessary to have a monetary limit? Why?

3.4 Reopening guidelines: allowing transactions to be reopened if lenders have not appropriately ascertained the ability of consumers to repay

New Zealand's Credit Contracts Act 1981 (section 9) allows a contract to be reopened if it is oppressive; and section 11 of the Act sets down guidelines as to when a contract will be considered to be oppressive. These guidelines allow the Court to have regard to all the circumstances relating to the making of the contract – but they would not necessarily allow the Court to consider the situation where a lender has not appropriately ascertained the consumer's ability to repay.

The Australian Consumer Credit Code allows the Court to reopen transactions that are "unjust". In determining whether a transaction is unjust, the Court may consider a number of matters laid out in the Code. One criteria is if it appears that the lender knew or should have known, at the time the contract was entered into, that the consumer was unable to repay the money due.[9] A guarantor is also able to apply to the Court for a reopening under this provision.

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[8] Section 66(3) of the Consumer Credit Code. No variation to the monetary limit is currently prescribed by regulation.

[9] The wording of the code is: "whether, at the time the contract, mortgage or guarantee was entered into or changed, the lender knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship" (section 70(2)(i)).

The aim of the Australian provision is to encourage lenders to consider the consumer's financial commitments, income, and expenditure (and perhaps also job stability) when assessing credit applications – rather than just applying credit-scoring techniques that focus more on a borrower's past credit record.[10]

The standard Australian text on the Code[11] explains that, at first glance, the provision can be read as indicating that a credit contract will be unjust if the lender relied on the loan's security rather than credit-checking as protection against the risk of non-payment. However, the Minister responsible for the introducing the Code into Parliament explicitly stated that the Code was not intended to be used against a lender if, at the outset of the loan, the borrower made it clear that they might have difficulty meeting their obligations and that they wished to proceed despite this. Rather, it is intended to deal with those lenders who consciously lend without making appropriate enquiries about the borrower's ability to repay.

Two other criteria the Court may have regard to when considering an application to reopen a contract are:

- whether the borrower or guarantor obtained legal or other expert advice before signing the contract or guarantee;
- the extent to which the provisions of the contract or guarantee and their legal or practical effect were accurately explained to, and understood by, the borrower or guarantor.

The Code requires the Court to have regard to the public interest, and to all the circumstances of the case when considering any reopening application.

3.4.1 Advantages

Such a provision provides an incentive for lenders to make full inquiries into the borrower's ability to repay. Lenders who have not made appropriate enquiries about a consumer's ability to meet their repayments will share in the cost of consumers' default.

Such provisions may be effective in making a lender responsible for being sure that a guarantor understood the nature of the guarantee he/she was signing. In some situations, it will be incumbent on the lender to suggest the guarantor receive legal advice. This may protect some consumers in "relationship debt" scenarios.

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[10] A Beatty, A Smith & A Barclay, (1997). *Annotated Consumer Credit Code and Regulations*, Butterworths, Australia.
[11] A Duggan and E Lanyon, (1999). *Consumer Credit Law*, Butterworths: Sydney, at 356-359.

3.4.2 Disadvantages

Reopening provisions of this kind must be drafted clearly. For instance, it is important that it is clear whether the provision is concerned with the circumstances surrounding the making of the loan, or with the actual terms of the loan. If it is not clear, this may result in different interpretations by the judiciary – as has happened in Australia under similar legislation.[12] This in turn leads to uncertainty for lenders.

It is often difficult to prove the conduct giving rise to an application; thus, these provisions are difficult to invoke. On the other hand, these provisions may be invoked opportunistically to frustrate the enforcement of the contract.

Is it appropriate to allow for the reopening of credit contracts based on:

- a lender's failure to make proper inquiries as to the borrowers ability to repay?
- whether a guarantor or co-signatory was encouraged to get independent advice?
- whether the effect of the terms of a contract or guarantee where sufficient explained to the borrower or guarantor?

What are your reasons for or against the inclusion of such provisions in consumer credit legislation?

3.5 Requiring lenders to undertake a "proper" budgeting process with borrowers

The Consumers' Institute has argued[13] that the law should require lenders to provide written proof that they have undertaken a "proper" budgeting process with a borrower, to ensure that the borrower can afford the loan. This would include having copies of bank statements to confirm the client's income and making a credit check with a credit-reference agency.

In most cases, it can be presumed that lenders do make credit checks to ascertain a client's ability to repay. This proposal has the added elements of a "proper budgeting process" and "written proof".

3.5.1 Advantages

This process may be helpful for consumers, and will force lenders to turn their attention to the consumer's current financial circumstances.

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[12] The Contracts Review Act 1980 (NSW) on which the Australian reopening guidelines were based. The reopening provisions under the both statutes have been strongly criticised by Duggan, (1991). "Some reflections on consumer protection and the law reform process", *Monash Law Review 17*(2), 252, at 273-77, and *Consumer Credit Law*, *supra*.

[13] Consumers Institute, (August, 1998). *The Reform of Consumer Credit Law in New Zealand*. Also available on the Institute's website www.consumer.org.nz/other/credit.

3.5.2 Disadvantages

"Written proof" of a "proper budgeting process" would place an unreasonable burden on those lenders who already take care over checking the ability of consumers to repay, and it will increase the cost of credit administration. This will ultimately be passed on to borrowers. Borrowers with a good credit rating may also find the process very inconvenient and uncomfortable.[14]

It would also be difficult to define a "proper budgeting process".

In the Ministry's view, a more desirable outcome would be achieved by a lesser test – that is, by requiring lenders to make a "reasonable attempt" to ascertain the consumer's ability to repay the debt. This requirement is already assumed in the option discussed above concerning the provisions in the Australian Consumer Credit Code – that is, the "reopening" of contracts in cases where lenders have not appropriately ascertained the ability of consumers to repay.

Should lenders have to go through a budgeting process with prospective borrowers before granting credit?
How might such a process work?

3.6 The wider picture

Social policy considerations relating to credit are largely outside the scope of the Consumer Credit Law Review. The Ministry believes that broad goals such as reducing personal indebtedness (including bankruptcy filings) and dealing with poverty are more appropriately dealt with by wider policy instruments.[15] Two options for this are considered below.

3.6.1 Education and dissemination of information

Education of consumers and lenders about their rights and responsibilities in relation to credit may help consumers in their financial decision-making. The aim would be to help consumers avoid over-committing themselves.

Consumer education and budgeting advice could receive more prominence in the school curriculum. People become consumers from childhood and might benefit from more life-skills instruction, including aspects of decision-making in relation to credit.

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[14] There may be issues under the Privacy Act 1993 as well. Information Privacy Principle One provides that information shall not be collected by any agency, unless:
(a) The information is collected for a lawful purpose connected with a function or activity of the agency; and
(b) The collection of information is necessary for that purpose.

[15] The Ministry notes that the review of New Zealand insolvency law currently being undertaken by the Ministry of Economic Development focuses on bankruptcy administration (i.e. the process once a borrower reaches the stage of bankruptcy) rather than on the causes of bankruptcies.

Another way of educating consumers is to target consumer information to beneficiaries and low income earners. Agencies that work with low income earners could be given this responsibility. It is apparent that beneficiaries and low income earners have a greater propensity than others to become overindebted: their economic position means that they are more likely to borrow out of desperation and without being able to repay. Also, they have a more limited range of sources for credit, and the money they borrow will typically incur higher finance charges (reflecting their greater likelihood of default).

3.6.2 Support for community agencies

A greater role might be played by the voluntary welfare groups which both educate consumers on good money management and assist consumers in financial distress. Currently, these groups include a nationwide network of Budget Advisory Services, as well as other community groups such as church and marae-based social services.

It may be possible to persuade lenders to give more support to these financial counselling agencies. Such a scheme – the Consumer Credit Counselling Service (CCCS) – was established in the United Kingdom in 1993.[16] CCCS employs full-time counsellors who work with clients to restructure their expenditure and to make agreed adjustments to their estimated budget. Repayment of debts with priority creditors (usually those who can disconnect essential services) are negotiated, and these payments are made on a monthly basis. If there is residual income, it is made available to non-priority creditors on a pro-rata basis. The unique feature of CCCS is that it is funded by subscribing lenders who voluntarily donate 15% of the money recovered from their debtors. There is no charge to debtors for the service.

There may be other ways in which lenders could provide assistance to borrowers – for example, by providing borrowers with written information, over and above the statutory disclosure requirements, about the consequences of default and also about avenues for assistance when problems arise in paying the debt. For instance, such notices could be sent with overdue account notices.

Are there other measures that could be introduced to assist consumers in avoiding becoming overindebted?
What is the role of:

- government?
- the voluntary welfare sector?
- the finance industry?

[16] The Credit Counselling Service is still in existence. See its Internet site at www.cccs.co.uk.

4. CREDIT-RELATED INSURANCE

It is in the interests of both lenders and borrowers to ensure that a borrower is able to continue repayment of a loan and – if the loan is secured – that adequate security is maintained. A means for achieving this is credit-related insurance.

Credit-related insurance is provided as part of a credit arrangement. The most common forms of credit-related insurance are:

- Goods insurance: This is insurance of goods purchased on credit or goods used as security. The goods can be insured against events such as fire, theft, damage, or loss. The consumer gets a benefit from this insurance and this benefit is independent of the credit contract secured by the goods.

- Consumer credit insurance (CCI): This ensures that repayments for a particular credit contract will continue to be made if the borrower dies, becomes ill, or loses their job. The "benefit" paid out will be the amount, or a specified proportion, still owing under the credit contract. CCI is also known as loan protection insurance, loan repayment insurance, credit insurance, and payment protection insurance.

- Life insurance: It is common for home-finance lenders to require a borrower to take out a life insurance policy, with the value of the policy being assigned to the lender to cover what the borrower still owes if they die. Life insurance taken out for the purposes of a credit contract can be treated as a variant of CCI.

- Lender's mortgage insurance: This insurance protects the lender, not the borrower. It is most commonly required when the consumer's equity in the property is small in relation to the mortgage. Policies vary in the risk they are insuring against. One type of policy insures the lender against any shortfall from a mortgagee sale. Other policies may protect the lender against a drop in value of the mortgaged property, or may insure against overdue repayments. The cost of lender's mortgage insurance is passed on to the borrower. Lender's mortgage insurance is also known as mortgage indemnity insurance.

4.1 The benefits of credit-related insurance

Both borrowers and lenders benefit from credit-related insurance.

Where a good is purchased on credit, both the supplier of the goods and the lender can use goods insurance to reduce the risk of financial loss if the goods are lost or destroyed in some way. Other forms of credit-related

insurance such as CCI help a lender avoid financial loss if a consumer defaults.

For consumers, goods insurance means that, if the goods they have purchased on credit are lost or stolen, they do not have to continue paying for them. CCI can lessen the difficulty of having to meet repayments if they fall ill or lose their job.

4.2 Problems with credit-related insurance

In the Ministry of Consumer Affairs' view, the nature of credit-related insurance is such that consumer detriment can easily arise. Common problems in credit-related insurance include:

- consumers paying excessive premiums for insurance
- policies not fully disclosed
- inappropriate insurance cover
- duplicate insurance cover.

4.2.1 Excessive premiums

There is a widespread belief that credit-related insurance tends to be overpriced when measured against the value received. This is particularly so for CCI.

Studies in Australia have concluded that CCI is priced uncompetitively.[17] This may also be the case in New Zealand. Industry organisations, as well as consumer groups, have often considered that CCI is overpriced, and the existence of overpricing is supported by a volume of anecdotal evidence.[18]

CCI premiums are relatively high because CCI is costly to administer and distribute, compared with other insurance products. The main reason for this is that CCI is sold "on commission" through lenders and suppliers, rather than directly from the insurer to the consumer. The cost of the commission is added to the cost of the insurance. Costs are also high because of the specialised nature of CCI, and because sales volume is relatively low.

There are additional factors that further weaken competitive forces, and inflate prices:

- In practice, lenders and suppliers sell only one insurer's CCI, so there is no competition at the point of sale. (It is unknown for a vendor to offer the consumer CCI policies from alternative insurers.) In fact,

[17] Trade Practices Commission, (June, 1991). "The market for CCI – a study of the competition, efficiency and welfare of consumers" *Report*; Australian Competition and Consumer Commission, (July, 1998). *Consumer Credit Insurance Review, Final Report*. No studies have been conducted in New Zealand.

[18] For example, complaints made to the Ministry of Consumer Affairs about hire purchase contracts show little relationship between the amount of a CCI premium and the cash price of the good being financed. The premiums are often a remarkably high proportion of the cash price.

"reverse competition" occurs: insurers bid against one another, offering more (rather than less) expensive policies on which the lenders/suppliers can recover higher commissions.

- Consumers are relatively unresponsive to the price and terms of the insurance offered to them. (In economic terms, the product is "price inelastic"). This is not surprising: in purchasing on credit, a consumer's attention is likely to be focused on the purchase of the merchandise (its attributes, its price, whether to purchase at all etc) and on whether or not they can obtain the credit. They are less likely to consider the price and terms of the insurance and in any event have little choice over this aspect.

- It is difficult for consumers to compare CCI products because of the inherent complexity of the whole transaction and their lack of familiarity with individual products (which in turn is due to the infrequency of the purchase).

- Lenders and suppliers which sell CCI have an incentive to inflate its price (where the market permits). For instance, falling profitability in the used car market may encourage suppliers to compensate for reduced margins on the sale of cars by increasing the price of the insurance. Similarly, increased commissions may compensate for reduced interest rates on credit contracts.

4.2.2 Policies not fully disclosed

Lenders, suppliers and insurers currently have no obligation to ensure that consumers are aware of the terms and conditions of credit-related insurance policies. Inevitably, some consumers are not even aware that they have purchased insurance. The disclosure entry is often noted merely as "CCI" (or "PPI") – and the application for insurance cover may be "buried" in the printed contract, which the customer is often encouraged to sign without adequate consideration and comprehension.

Such limited disclosure in insurance policies prevents consumers from understanding essential terms, such as the amount of the premium, claim entitlements, the extent of insurance cover provided, and the term of the policy. This will restrict their ability to compare insurance products and – where they have the choice – to determine whether they should accept the insurance cover at all.

Furthermore, some suppliers do not offer insurance through an independent insurer. Instead they "self-insure" through devices such as repayment waivers (see page 17 for a discussion of repayment waivers) and extended warranties. In these situations there is less likely to be full disclosure. Independent insurers, by contrast, will generally have a standard-form written contract, which has disclosure of its main conditions and is usually given to the consumer.

4.2.3 Inappropriate insurance cover

Consumers are sometimes required by lenders or suppliers to take out insurance that covers unlikely risks – or that does not cover likely risks. Typical examples that have come to the Ministry's attention include:

- A forestry worker's CCI policy expressly excluded cover for injuries suffered while engaged in forestry work.

- An unemployed consumer was sold insurance to cover redundancy.

- Insurance to cover the event of unemployment, where the maximum benefit payable under the policy is close to the premium.

At a more general level, the Ministry notes that consumers are commonly required to take out CCI in spite of it being reasonable to assume that they are unlikely to lose their job or that, if they do, they will still be able to service the loan. There is nothing in legislation to prevent suppliers from requiring goods insurance and/or CCI.

4.2.4 Duplicate insurance cover

Sometimes consumers are required to purchase credit-related insurance cover for goods when their existing contents insurance policy would adequately cover this. They are effectively paying twice for the same cover.

4.3 Policy response

From its analysis of the problems discussed above, the Ministry has identified seven areas for possible reform. These are:
- defining "credit-related insurance"
- establishing whether the lender has a right to require this insurance
- establishing who has the right to nominate the insurer
- requiring the lender to disclose the terms of the insurance
- a "cooling-off" period for credit-related insurance
- requiring insurance to be appropriate
- restrictions on the commission received by lenders and suppliers.

4.4 Defining credit-related insurance

Any regulation of credit-related insurance will need to define "insurance" for the purpose of credit legislation. Some contractual devices, not always understood to be insurance contracts, can be used by lenders and suppliers to avoid existing legal requirements. These include extended warranty contracts and repayment waivers.

4.4.1 Extended warranty contracts

An extended warranty contract is an agreement where, in return for an additional payment, the supplier will repair or replace defective goods outside the usual manufacturer's warranty period. If the warranty

extends to risks that are unrelated to the quality or suitability of the product, an extended warranty contract can be considered to be insurance.[19] This is particularly so, if the warranty is given by a third party.

An extended warranty may be a device used to avoid regulatory requirements in relation to insurance.

Should credit-related insurance be defined to include or exclude these forms of extended warranty contracts?

4.4.2 Repayment waivers

A repayment waiver is an arrangement whereby a lender or supplier agrees to waive their rights to repayments if the consumer dies, or becomes incapacitated or unemployed. The consumer can "purchase" a repayment waiver, at an additional cost.

The High Court has held, in a judgement concerning the application of the Insurance Companies Deposits Act 1953, that this arrangement is not an insurance contract.[20] However, in the consumer credit context, the impact of the ruling may be undesirable because, generally, a repayment waiver appears to be identical in function to CCI – which suggests that repayment waivers should be regarded as credit-related insurance.[21]

Should credit-related insurance be defined to include or exclude repayment waivers?

4.5 Should the lender have the right to require insurance?

A lender or supplier currently has a right to require any type of insurance. There is nothing in legislation to prevent them from requiring insurance.[22] Thus, a lender or supplier has the right to require CCI to be taken out by borrowers – either from a third party[23] or through a device such as a "repayment waiver".

[19] This is the position in US case law: in *Ollendorf Watch Co v Pink* 17 NE (2d) 676 (1938) a seller of a watch also provided a warranty that the watch would be replaced if stolen. The Court held this went further than a warranty and deemed the contract to be one of insurance.

[20] As a result of the decision in *Motorcycle Specialists Ltd v Attorney General* (1988) 2 NZBLC 103 358, per Davison CJ. The decision concerned the application of the Insurance Companies Deposits Act 1953. This Act requires a company to make a deposit, or otherwise secure a deposit with the Public Trustee, if it is carrying on certain types of insurance business. The reasoning in this case has been criticised on various grounds e.g. D Kelly and M Ball (1991). *Australian Insurance Law* (2nd Ed.); U Jagose (1994). *Consumer Protection Insurance in New Zealand: An Examination of Law and Practice*, LLM Thesis, Victoria University of Wellington.

[21] We are not proposing that repayment waivers should be treated as insurance for the purposes of the Insurance Companies Deposits Act or other general insurance statutes.

[22] The only restriction is in section 40 of the Hire Purchase Act, which requires lenders to use an independent insurer. This provision applies only in the context of a hire-purchase arrangement.

[23] In Australia, the supply of goods or services on condition that the purchaser acquire goods or services from a particular third party, or the refusal to supply because the consumer will not agree to that condition, is called "third-line forcing". Third-line forcing is illegal under the Trade Practices Act 1974.

New Zealand is at variance with Australia on this. The Australian Consumer Credit Code (section 133) provides that a lender cannot insist on insurance being taken out by the debtor unless the insurance is "compulsory insurance",[24] insurance over mortgaged property, or mortgage indemnity insurance. There is provision for regulations to be made to include other forms of insurance in this list, but there are as yet no such regulations.

The discussion now deals with the lender's right to require credit-related insurance in four areas:

- consumer credit insurance (CCI)
- life insurance
- lender's mortgage insurance
- insurance of secured goods.

4.5.1 Consumer credit insurance (CCI)

These policies can be expensive, and are often of dubious benefit. If the lender also takes security sufficient to cover the balance outstanding under the contract, then it is already protected from the possibility of loss.

There are three key arguments (and counter-arguments) to be considered here:

Argument 1: For the lender, CCI provides an alternative source of repayment if the borrower defaults.
Counter-argument: If the loan has sufficient security, there is no justification for requiring CCI. There may, however, be a case for CCI when the loan is unsecured or under-secured.

Argument 2: Consumers who do not wish to pay for CCI can seek out other lenders who do not require CCI.
Counter-argument: There can be significant transaction costs for a consumer in negotiating credit deals, or in obtaining quotations. Also, in some markets, or for some categories of consumer, it may be difficult to find credit offers that do not include compulsory CCI. (There is no real opportunity for consumers to shop around for different CCI policies, as CCI is not sold direct to the public.)

Argument 3: CCI reduces the uncertainty of lending to consumers who are not good credit risks (for example, because they are likely to become sick, injured or be made redundant). Without purchasing CCI, these consumers are likely to be denied credit.
Counter-argument: Lenders should not be encouraged to make credit available to high-risk consumers. Nor should low-risk consumers have to cross-subsidise insurance for high risk consumers. It is not in the interests of insurers to allow CCI to be sold regularly to high-risk

[24] That is, compulsory third-party injury insurance.

consumers. CCI is for unexpected contingencies rather than likely defaults, and it is not a substitute for adequate risk-assessment of a borrower.

Should lenders be prevented from making CCI a compulsory condition of entering into a credit contract? or
Should lenders have the right require borrowers to take out CCI as a condition of getting credit?
Should lenders be permitted to make CCI a compulsory condition of an unsecured loan only?

4.5.2 Life Insurance

Lenders often require life insurance to be taken out as a condition of a loan particularly for home finance. The borrower then assigns the life insurance to the lender, to protect the lender's interest in the event of the borrower's death.

The arguments concerning whether lenders should be able to make life insurance a compulsory condition of a loan are similar to those for CCI. However, one difference is that life insurance policies are available more generally than CCI, providing the consumer with an opportunity to "shop around" or to assign to the lender an existing life insurance policy.

Should lenders be permitted to require life insurance as a condition of receiving credit?
What conditions should be placed on the lender's right to require life insurance?

4.5.3 Lender's mortgage insurance

It is a common requirement of home finance that the borrower pays for the lender's mortgage insurance, particularly when the consumer has little equity in the property. The high value of the mortgage may justify this. Furthermore, real estate values have on occasions dropped significantly, substantially reducing the borrowers equity. When this happens it leaves the lender vulnerable to being under-secured.

In the Ministry of Consumer Affairs' view, lenders should not be prevented from requiring mortgage indemnity insurance.

4.5.4 Insurance of secured goods

A lender has a legitimate interest in maintaining the value of property over which it has security. If the property is damaged before the loan is repaid, the lender effectively loses its security unless it can receive the insurance proceeds. Therefore, lenders are entitled to require consumers to make special arrangements with their existing insurers or alternatively take out separate insurance for those goods.

The Ministry of Consumer Affairs supports the status quo – that is, there should be nothing in law which prevents lenders from requiring insurance over secured goods.

4.6 Should the lender have the right to both require insurance and choose the insurer?

The Hire Purchase Act allows a lender to require goods insurance to be purchased from a nominated insurer. Lenders in other credit-contract arrangements may also require insurance to be taken out with a nominated insurer.

Allowing lenders to require insurance and also to nominate an insurer limits competition at the point of sale, which in turn allows lenders and suppliers to charge higher premiums than they would be able to if they were in a competitive situation. It can also oblige consumers to duplicate their insurance cover for goods, if they already have contents insurance.

New Zealand differs from both Australia and Canada on this:
- Australia's Consumer Credit Code provides that a lender cannot require the consumer to choose a particular insurer in connection with a credit contract unless the insurer is the only provider of that particular insurance.
- In Canada, the Uniform Cost of Credit Disclosure Act proposes that whenever the consumer is required to take out insurance, they must have a choice of insurer. This right must also be disclosed by the lender.

There are five arguments (and counter-arguments) to be considered here.[25]

Argument 1: If consumers are not satisfied with the lender's insurer, they can "shop around" for a lender who gives a choice of insurer. (Some hire-purchase retailers advertise the fact that they give the consumer a choice of insurer.)
Counter-argument: There are transaction costs for a consumer in negotiating or obtaining quotations for any type of financial arrangement. In the hire-purchase market, consumers are more likely to focus their "shopping around" on the goods they are buying, rather than on the insurance deal.

Argument 2: The provision of insurance as part of the credit contract allows lenders to extend credit to high-risk consumers. If consumers were free to chose their own insurers, low-risk consumers would be more likely to choose their own insurance and the lender's insurers would be left with the high-risk consumers. The insurer would most likely refuse to continue providing insurance through that lender, to the detriment of high-risk consumers.
Counter-argument: Lenders should not be encouraged to lend to high-risk consumers (even if these consumers do take out insurance). Also, low-risk consumers should not be cross-subsidising insurance policies

[25] This section summarises arguments that have been made by lenders and retailers when similar issues have been raised in the past by the Ministry of Consumer Affairs and the Department of Justice.

for high-risk consumers, who otherwise would be unlikely to receive credit – ultimately, an insurer will not provide insurance through a lender who has a significant proportion of high-risk customers.

Argument 3: Because lenders have an interest in the insurance policy, they often enter into special arrangements[26] with insurers to note this interest. For example, the insurer may agree that, if there is non-payment of the premium, they will not let the policy lapse without first notifying the lender. These sorts of agreements are efficient for lenders and insurers.
Counter-argument: Insurers will generally agree to note the interest of lenders, when a consumer enters into a secured credit contract. Lenders should be entitled to impose a duty on the consumer's insurer to notify of any lapse in policy. Following the Australian approach, it would seem reasonable to allow lenders to restrict the consumer's choice of insurer to those insurers with which the lender has an agreement of this kind. Nonetheless, the borrower still must have a choice of insurer.

Argument 4: Consumers may allow their credit-related insurance cover to lapse, or may cancel it. When insurance has been arranged independently by the borrower, it is difficult for a lender to monitor whether this insurance is being maintained.
Counter-argument: As above, in counter-argument 3, lenders should be able to require insurers to provide notification if the consumers let a policy lapse. Consumers who fail to keep the goods insured will be in breach of the contract. A breach of contract gives the lender certain rights – including seizing the security, cancelling the agreement, or demanding full payment of the amount outstanding. If these rights of the lender have been disclosed, the borrower will have an incentive not to let the policy lapse.

Argument 5: Preventing lenders from nominating the insurer may limit innovation. For example, the ability to provide "bundled" credit products where, in return for purchasing particular insurance, the consumer may be offered a lower cost of credit.
Counter-argument: Lenders and suppliers could still offer such bundled credit products. The proposal will not prevent lenders from reducing the cost of credit, in return for the consumer's acceptance of its insurance policy, provided that where the prospective borrower declines to take out the insurance or to take out that insurance with a particular insurer, the credit is still available, albeit without the proposed reduction in the cost of that credit.

4.6.1 Additional issues

Lenders have an interest in ensuring that insurance is taken out with reputable companies. If consumers were to have a choice of insurer, it appears reasonable to allow for ***a lender's right to approve the consumer's choice of insurer***. Approval should only be withheld on reasonable grounds.

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[26] Sometimes called "concessions agreements".

The Hire Purchase Act provides that if a consumer is to be required to insure with a particular insurer, this must be ***an independent insurer***.[27] An independent insurer means "any reputable insurer carrying on business in New Zealand except an insurer which is owned or controlled by the vendor or the dealer or which is a subsidiary or the holding company or a subsidiary of the holding company of the vendor or the dealer." It does not prevent the supplier or lender from entering a commission arrangement with the insurer.

Which option do you support:
- The status quo: lenders should be permitted to require borrowers to take out insurance with a nominated company.
- Lenders should be permitted to require borrowers to take out insurance with an *independent* nominated company.
- Prohibiting lenders from requiring borrowers to take out insurance with a particular company unless the insurer is the only one providing insurance of the relevant kind.

4.7 Disclosure of policy

Under current law, lenders are not required to disclose the terms of the insurance cover sold to a borrower.

The Ministry of Consumer Affairs proposes that credit-related insurance policies should be clearly disclosed to the borrower within 15 working days of acceptance by the insurer.

There are no obvious disadvantages to consumers or lenders in this proposal, although attention will need to be given to the form and extent of the disclosures.

Information that could be usefully disclosed to consumers includes:
- the name and address of the insurer
- the term for which insurance is provided
- the type of insurance
- the amount of the insurance premium
- the risks which the insurance covers
- the exclusions under the insurance policy
- any statutory rights in relation to the policy (such as a right of cancellation).

4.7.1 Additional issues

One issue raised in the past has been whether ***lenders and suppliers should be required to disclose the insurance commission they receive***. Requiring the disclosure of commissions may have a competitive effect if consumers believe they can get a similar policy elsewhere for a

[27] The Contracts and Commercial Law Reform Committee, ((February, 1977). *Credit Contracts: Report of the Contracts and Commercial Law Reform Committee,* at 149), whose proposals led to the Credit Contracts Act, recommended that a similar provision should be included in the Credit Contracts Act.. This suggestion was not implemented.

smaller commission. They may resist signing up to policies with a high commission.

On the other hand, consumers may attach relatively little importance to this information. In deciding whether to accept an insurance policy, and in comparing policies, consumers may be more concerned with the total cost of the insurance.

How should credit-related insurance policies be disclosed to consumers? What items should be disclosed? Should the amount of commission be disclosed?

4.8 A reconsideration ("cooling-off") period for credit-related insurance

A further issue is a reconsideration ("cooling-off") period for consumers purchasing credit-related insurance. This would allow consumers to evaluate the terms of the contract in an unpressured setting. Consumers usually have little opportunity to read a contract before signing but will be expected to comply with it.

The Credit Contracts Act already gives borrowers three days to cancel their credit contract once disclosure has been made. Cancellation of a credit contract will also have the effect of cancelling any credit-related insurance contract. However, consumers do not have the right to cancel the insurance on its own.

A reconsideration period for the insurance contract would make the two contracts consistent.

This would also allow the consumer opportunity to focus their attention on the insurance aspect of the overall arrangement. Because the consumer is primarily interested in the goods being sold, and in whether or not they can get credit, they are less likely to consider the terms of the insurance policy at the time of signing up for the credit. A reconsideration period may allow them to do this (and to seek alternative insurance).

A reconsideration period for insurance, however, may lead to uncertainty for lenders about whether the goods are insured during this period. Any proposal for a reconsideration period would need to take account of this risk.

Should consumers be entitled to a cooling-off period after the disclosure of a credit-related insurance contract?
How long should the cooling-off period be?

4.9 Requiring insurance to be appropriate

Section 40 of the Hire Purchase Act makes it an offence for a supplier to require a borrower to insure goods against risks, or on terms and

conditions, that the supplier would not require if they had arranged the insurance for themselves.

This requirement, however, exists only for insurance of goods that are on hire-purchase. It does not cover the insurance of goods bought under other forms of credit. Nor does it cover other types of credit-related insurance such as CCI.

The Ministry of Consumer Affairs believes that legislation should prevent a lender or supplier from making unreasonable requirements about the terms on which insurance is to be taken out.

This is similar to the Australian Consumer Credit Code's section 133(2)(b). It is also broadly consistent with section 40 of the Hire Purchase Act.

Any legislative provision on this would need to be carefully drafted to make it clear what is intended by the phrase "unreasonable requirements".[28]

4.9.1 Restriction on commissions

The Australian Credit Code limits to 20 percent the commission that can be received by a lender or supplier from an insurer, or that an insurer can pay. This measure was passed in response to the problem of excessive premiums.

It has been noted in Australia that this restriction is unlikely to be effective in reducing the premiums for CCI. Increased administrative and compliance costs involved in capping commissions may offset the benefits. Further, lenders and insurers have found innovative ways to avoid this restriction, such as by establishing a joint venture company so that profits can be distributed through dividends.

The Ministry does not propose a cap on the commissions received by lenders/suppliers or paid by insurers.

[28] "Unreasonable" is not defined in the Australian Code. However, Duggan and Lanyon suggest that a requirement may be unreasonable if it is unreasonably difficult to comply with, or not reasonably necessary for the protection of the legitimate interests of the lender or supplier, or where the terms of the transaction are not justified in light of the risks undertaken by the party. They also suggest that the Court may draw on the provisions for unjust contracts in section 70 of the Code, supra, at 316.

5. CREDIT CONTRACTS VIA THE INTERNET

Banks, many finance companies and some financial brokers now have Internet sites that give prices and information about their consumer credit products.[29] Some of these allow consumers to apply for personal loans over the Internet. But they do not allow the credit arrangement to be completed online – largely because current legislation does not accommodate electronic credit transactions.

As internet banking and the associated technology continues to develop, pressure is likely to come from consumers and lenders for the law to recognise e-credit transactions. A number of submissions in response to the Ministry of Consumer Affairs' introductory paper in this series[30] urged that attention be given to the issue – and, in particular, to the relationship between e-credit and the current requirements for written documents and signatures.

5.1 Effect of current legislative requirements on e-credit

There are several Acts that currently limit the expansion of e-credit – either by requiring information or notices to be given in writing, or by requiring that documents be signed.

5.1.2 Credit Contracts Act 1981

The Credit Contracts Act contains a number of disclosure requirements. Section 20 and 21 of the Act also make it clear that these disclosures must be in writing, and in a form in which they can be "given" to the consumer or sent by post.

Section 22 gives a borrower the right to cancel a controlled credit contract – but only by giving written notice to the lender.

These requirements appear to exclude the use of electronic transactions.

5.1.3 Hire Purchase Act 1971

Section 5 of the Hire Purchase Act requires that every hire purchase agreement must be in writing. It must be "executed" (signed) by the consumer.

Section 7 provides that the agreement must be given to the consumer. It also contains other requirements as to the form of the agreement.

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[29] Most banks also provide Internet banking for consumers. This usually covers services such as account information, bill payments, and money transfers.

[30] Ministry of Consumer Affairs, (June, 1999). *Consumer Credit Law Review, Part 1, Setting the Scene.*

It is doubtful whether electronic transactions would meet the requirements of the Hire Purchase Act.

5.1.4 Credit (Repossession) Act 1997

When a lender seeks to repossess the secured goods of a defaulting borrower, sections 8 and 9 of this Act require the lender to serve a pre-possession notice on the borrower. This notice must be in writing and must be either personally served or sent by post.

Similar requirements are in place to cover the situation after the goods have been repossessed. Section 21 provides that a post-possession notice must be served on the borrower who had their goods repossessed.

Electronic notices would not meet the requirements of the Credit Repossession Act.

5.1.5 Other requirements

The Chattels Transfer Act 1924 provides that any secured loan pursuant to an Instrument by Way of Security must be in writing and signed. This Act is soon to be repealed. It will be replaced by the Personal Property Securities Act 1999, which gives electronic documents the same recognition as paper-based documents.

5.1.6 Conclusion

The requirement that notices or contracts be in writing does not in itself rule out electronic communications in consumer credit. This is because the Interpretation Act 1999 has the effect of allowing electronic equivalents to satisfy legislative requirements for writing. However, the additional requirements in legislation that notices be given and/or signed do appear to rule out electronic equivalents.

5.2 Implications of the proposed Electronic Transactions Bill

The Government is considering the enactment of an Electronic Transactions Bill. Broadly speaking, the Bill is likely to contain provisions to facilitate electronic communications by recognising them as being as legally valid as more traditional paper-based communications – which means that a requirement that something be “posted” could be fulfilled by electronic delivery, and that an electronic signature would be adequate whenever something must be signed.

The Bill would override all existing paper-based requirements, except for those specifically exempted. Exemptions may include the “notice” provisions of the Credit Repossession Act.

Where the Bill does apply, it would ***allow*** electronic documents to be used in place of written documents. Any requirement to keep original copies of a document will be fulfilled if the document can be stored on a computer – e.g. as a web page or on a hard drive – in its original form.

Electronic signatures[31] will suffice for written signatures. Lastly, e-mail or electronic delivery will likely have the same status as a physical mailing.

There are, however, some qualifications to this. One is that both parties must consent to the use of electronic communications: the Bill will be facilitative and will not require anyone to use electronic communications who does not wish to do so.

This qualification may be weakened, however, if lenders' standard-form contracts contain a clause denoting the consumer's acceptance of electronic communications. As consumers do not usually read the "fine print" contained in standard-form contracts, they may consent to electronic communications without realising it. This has the potential to negate their right to refuse electronic communications.

5.2.1 The principles behind the recognition of e-transactions

The key principles behind the Bill and its recognition of electronic transactions are functional equivalence and technological neutrality.

- ***Functional equivalence*** means that electronic communications and documentation should be given the same recognition as paper-based (or other) communications and documentation, if they perform the same function.
- ***Technological neutrality*** means that the law should not discriminate between different types of technology.

5.3 Policy response

In certain contexts electronic communications are not desirable. This is where there is strong justification for requiring something to be on paper, or to be manually signed. [32]

There are important policy objectives for requiring that consumer credit contracts be in writing, or that such contracts be signed.[33] These can be described as:

- evidentiary
- cautionary
- protective
- record-keeping.

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[31] There is no definition of "electronic signature". It is understood as being any means of electronic authentication of the identity of a person and of the intent of that person to be associated with the signature.

[32] The remainder of this chapter owes much to the following source: Ministerial Council of Consumer Affairs, (June, 1999). *Uniform Consumer Credit Code Post Implementation Review Final Report*, at 106-130 (available at www.creditcode.gov.au); also E Lanyon, "Hybrid consumer credit products in the electronic age – a challenge for regulators", Paper presented to the International Association of Consumer Law Biannual Conference, Helsinki, Finland, May, 1999; New Zealand Law Commission (1999). *Electronic Commerce Part Two: A Basic Legal Framework.*

[33] These policy objectives have been detailed in the Australian context by Associate Professor Mark Sneddon (1998). "Legislating to facilitate electronic signatures and records: exceptions, standards and the impact on the statute book", *UNSW Law Journal*, 21(2), 334-403. Sneddon also describes a "channelling" objective, however it appears to be indistinguishable from other objectives listed above and is therefore not discussed.

The ***evidentiary*** objective of writing is to ensure the existence of a durable record of information; the evidentiary objective of a signature is to ensure that there will be admissible and reliable evidence.

The ***cautionary*** objective of a signature is its capacity to encourage deliberation and reflection before action. It signifies that the document has legal consequences.

The ***protective*** objective of a signature is to provide evidence for others that the signature-maker has given their full attention to the document.

The ***record-keeping*** objective of writing is to create a durable record of an arrangement and its terms; the record-keeping objective of a signature is to record the parties to an arrangement.

It is important that these objectives are not undermined by the policy of functional equivalence. For instance, an electronic signature on an electronically formed loan contract must be reliably authenticated for it to satisfy the evidentiary objective of a handwritten signature. Similarly, the act of making the electronic signature must convey the same caution and sense of legal significance to the consumer that the act of manual signature conveys. Otherwise, the cautionary objective is not met.

The Ministry of Consumer Affairs believes that consumer credit regulation should not prevent electronic transactions. As more and more business moves to the online environment, it will become anomalous and unhelpful if credit transactions are excluded.[34] The challenge, however, is to maintain the policy objectives of evidence, caution, protection, and record-keeping.

The Ministry has identified seven issues in e-credit transactions that need further discussion:

- the reliability of electronic communications
- date of commencement of the contract
- verification of the sender (of communications)
- confirmation of the consent to purchase credit
- form and presentation of information
- storage and reproduction of documents
- cross-border consumer credit.

5.3.1 The reliability of electronic communications

In general, there are likely to be few problems with electronic communications. However, many factors beyond the control of a consumer can make electronic communications less reliable than regular postage – such as problems with hardware, software, Internet Service

[34] Ministry of Consumer Affairs, (April, 2000). *Consumer Credit Law Review, Part 3: Transparency in Consumer Credit: Interest, Fees and Disclosure*. The Ministry discussed the advantages of the Internet for price comparison between lenders and for overcoming problems with disclosure, such as the timing of information (section 6.3, on pp 31-32). The possibility of a centralised third-party disclosure mechanism was also raised (section 9.5, on pp 61-62).

Providers, and electricity suppliers. By contrast, a physical posting address is usually more reliable.[35]

This suggests some restrictions on electronic communications may be necessary. Such restrictions might include:

- The consumer must have an electronic address to which communications must be sent, and must have a means of notifying a change of this address.
- The consumer must choose to receive notices electronically, and must have a right to cancel this choice.

These restrictions would still allow electronic delivery of most "notices" – such as those required for continuing disclosure under the Credit Contracts Act.

Where a notice or other information has particular significance, however, these restrictions may be inadequate for protecting consumers.

One example of this is default or repossession notices that require an urgent or time-bound response.

The Ministry proposes that electronic delivery of such notices should not be permitted to substitute for physical mailing.

Another example is initial disclosure. Under the Credit Contracts Act, the borrower has three working days to cancel a contract after receiving initial disclosure. As electronic communications are not always reliable, there may be a case for requiring that the borrower receives paper-based disclosure as well as electronic disclosure.

Should initial disclosure under the Credit Contracts Act remain paper-based?

5.3.2 Date of commencement of a contract

The law is currently unclear in determining when an electronic contract has been formed. The time at which a contract was made is important because most of the statutory requirements for contracts run from (or for) a certain time period.

A contract is formed through a process of offer and acceptance – and the commencement date of a contract depends on the time of "dispatching" (sending) and the time of receiving the offer/acceptance. The Electronic Transactions Bill is likely to take steps towards clarifying the commencement date of a contract, by creating a default rule for the times of dispatch and receipt.[36]

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[35] The Ministry is satisfied that notices being lost in the post is a rare event.

[36] The Bill is also likely to create a default rule for the places of dispatch and receipt. "Place", however, is rarely an issue in consumer credit.

Under the Bill, the time of dispatch is likely to be deemed to be when the electronic communication enters an information system, which is outside the control of the originator of that communication. The time of receipt will be deemed to be *either* when the communication first reaches the addressee's information system (if the recipient has designated an information system for this purpose), *or* when the communication comes to the attention of the addressee.

It is likely that the default rules will be alterable by agreement between the parties. This could be a problem in consumer contracts, especially when the contract is a standard-form contract. Standard-form contracts can alter the default rules in ways that are unfair to consumers – for example, by deeming that information has been received within a certain time of having been sent by e-mail.

In Australia it was recommended that reliance on any variation to a default rule should be subject to section 68A(3) of the Trade Practices Act 1974. This provides that, in determining whether reliance on a term of the contract is fair and reasonable, a court shall have regard to the circumstances of the case – particularly the strength of the bargaining position of the parties. New Zealand has no equivalent provision.

The Ministry therefore proposes that the default rules as to time of dispatch and receipt proposed in the Electronic Transactions Act should not be departed from.

5.3.3 Verification of the sender

The issue of default rules also arises in verifying who sent the communication. The Electronic Transactions Bill is likely to state that (unless otherwise agreed) the purported sender and the recipient of an electronic communication are bound by a particular communication only if the communication was indeed sent by that sender, or with their authority.

It may be desirable to place a limit on departures from these default rules, as problems may arise if standard-form contracts use other rules.

The Ministry proposes that the default rules as to the verification of the sender proposed in the Electronic Transactions Act should not be departed from.

5.3.4 Confirmation of consent to purchase credit

In Australia, consideration has been given to whether the instantaneous nature of the Internet means that a consumer might purchase credit inadvertently, or with less consideration than they intended.[37]

[37] Ministerial Council of Consumer Affairs, supra, at 123-125.

For instance, it may be inappropriate for a credit contract to be completed after a single click of a mouse. Clicking "OK" icons is a routine aspect of using the Internet. It may not bear the significance necessary to meet the cautionary and protective objectives inherent in written documents and signatures. The conclusion reached by officials in Australia was that the actual agreement should not be denoted by a mere click, and that a digital signature would be a more appropriate device for denoting agreement.

One Australian commentator[38] has further suggested that a "clicking" process should mark the commencement of a formal contracting process, separating it from the initial advertising and product-information stage.

The OECD's guidelines on consumer protection[39] also propose a multi-step confirmation process. In this process, a consumer confirms their interest in contracting and their agreement to all the terms and conditions. A multi-step process is likely to increase the chance that a consumer's agreement is informed and unambiguously expressed.

What safeguards should be provided to insure consumers consent to purchase e-credit knowingly?
Should an electronic signature be required?
Should a "multi-step" clicking process be required?

5.3.5 Form and presentation of information

Presentation of contractual information generally was discussed in *Consumer Credit Law Review, Part 3: Transparency in Consumer Credit: Interest, Fees and Disclosure*.[40] The Ministry suggested there that a performance standard, rather than prescribed details, should govern the presentation of contractual and disclosure information. This now raises the question of whether a performance standard is appropriate for e-credit transactions – or whether more prescription is necessary. The principle of "technological neutrality" would suggest that a performance standard be applied to all credit transactions, regardless of whether they are electronic or paper-based.

Australian consideration of this issue[41] concluded that there should be size-specifications for the fonts used in electronic documentation – but this is consistent with their requirements for font size-specifications in paper-based documents. It was also suggested in Australia that consumers should have to scroll through the contract before agreeing to it, to ensure that they "saw" the entire document.

The Australian review also noted that, to be effective, statutory warnings and disclosures need to convey a sense of significance. This could be undermined if, say, a warning was combined with flashing advertising

[38] Lanyon, supra.
[39] Recommendation of the Council Concerning Guidelines for Consumer Protection in the Context of Electronic Commerce, December, 1999. The guidelines are available at www.oecd.org/dsti/sti/it/consumer.
[40] Supra.
[41] Ministerial Council on Consumer Affairs, supra, at 118-119.

icons, which are common on web pages and which may distract the consumer. It is important that contractual information be separated from advertising material.

What provisions are appropriate to regulate the form and content of contractual information provided electronically?
Is a performance standard sufficient?

5.3.6 Storage and reproduction of documents

Consumer credit legislation places various requirements on lenders to "give" information to a consumer – usually the contract document, or a disclosure document. This ensures that the consumer has a copy that can be stored and retrieved as a record of the transaction, and of its terms and conditions.

The main issue here is that the documents must be in a form that the consumer can keep and retrieve.

E-mail messages or attachments can be saved on a computer and printed out – and so can be easily stored and retrieved by the consumer.

But if a lender posts information on a web page rather than communicating directly with the consumer, this presents the consumer with problems of storage and retrieval. The approach taken in the US is that if information is to be posted on a web page, the consumer must be given notice of this. They must also be given instructions on how to download the page, so that it can be saved. (Matters that might be notified on a web page include changes in interest rate.)

A further issue is that information needs to be free from subsequent alterations. Its "integrity" is important for determining whether it is the original document agreed to by the parties. The Electronic Transactions Bill is likely to specify that a document can be regarded as original only if its integrity is assured. This will put an onus on lenders to ensure that their electronic documents are tamper-proof.

What views do you have on the issues concerning the storage and reproduction of electronic communications?
Should statutory information be permitted to be disclosed on a web page?
If so, are any safeguards needed?

5.4 Cross-border consumer credit

One of the features of electronic commerce is the breaking down of international borders. New Zealand consumers increasingly purchase goods over the Internet from all around the world, and it is possible that in the future they will be able to access credit from overseas.

It would be possible for New Zealand law to provide statutory rights to consumers borrowing from overseas. However, the benefit of this would be questionable if the Government was unable to effectively regulate the conduct of overseas based lenders.

The Ministry of Consumer Affairs does not foresee significant issues arising in this area because there are legal and practical barriers to the extension of cross-border credit. The legal barrier is that of jurisdiction – determining which country's law applies in relation to cross-border credit transactions. The practical barrier for lenders is the difficulty in enforcing their rights when they are located in another country; the practical barrier for consumers is that New Zealand consumer-credit laws will not necessarily protect New Zealanders who enter into an e-contract with an overseas firm. Clearly, there are risks for both parties. In the Ministry's view, truly international consumer credit is unlikely to become widespread, at least in the foreseeable future.

Do you think the development of cross-border credit is likely? What are the main issues?

APPENDIX ONE

Current regulation of credit-related insurance

The extent to which credit-related insurance is regulated by legislation, and by the market itself, is outlined below.

Chattels Transfer Act 1924
The Chattels Transfer Act gives lenders and suppliers the right to require insurance against fire and to approve the insurer used by the borrower.

This Act will be repealed when the Personal Property Securities Act 1999 becomes law (this date is yet to be set). The Personal Property Securities Act, however, does not contain any requirements that relate to insurance.

Hire Purchase Act 1971
The Hire Purchase Act allows hire purchase suppliers to require the purchaser to insure, and to keep insured, goods that are the subject of a hire purchase transaction. The insurer must be independent. The supplier has the right to nominate the insurance company.

Section 40 of the Act makes it an offence for a supplier to require a borrower to purchase insurance against risks, or on terms and conditions, that the supplier would not require if it had arranged the insurance personally. But there is nothing in the Act to prevent a supplier from requiring “duplicate” insurance – that is, requiring insurance for an item when the borrower already has a policy that would cover it.

Section 23 of the Act specifies that a borrower who repays a hire-purchase transaction early is entitled to a rebate of the premium.

The Hire Purchase Act makes no reference to consumer credit insurance (CCI).

Credit Contracts Act 1981
The Credit Contracts Act does not currently regulate credit-related insurance.

Land Transfer Act 1952 and Property Law Act 1952
Covenants implied under these Acts oblige a borrower to insure the mortgaged property against damage by fire. The insurer must be approved by the lender.

Self-regulation of the insurance market
The Insurance Council of New Zealand and the Life Offices Association have established self-regulatory complaints resolution schemes.

The Insurance and Savings Ombudsman is one of these schemes. Approximately 75 companies participate in the scheme, and complaints about credit-related insurance provided by these companies can be heard by the scheme's ombudsman.

APPENDIX TWO

Insurance provisions in Australian Consumer Credit Code

Section	Provision
132	Meaning of credit-related insurance contract
133	Requirement to take out insurance or to insure with particular insurer or on particular terms
134	Financing of insurance premiums over mortgaged property
135	Commission for consumer credit insurance
136	Supply of copy of credit-related insurance contract by insurer
137	Rejection of debtor's proposal for insurance
138	Termination of consumer credit insurance contract if credit contract terminated
139	Termination of insurance contract over mortgaged property if credit contract terminated