Coversheet: Consumer credit regulation review

Advising agencies	Ministry of Business, Innovation and Employment (MBIE)
Decision sought	Amend the Credit Contracts and Consumer Finance Act 2003 (CCCFA) to improve consumer credit regulation
Proposing Ministers	Hon Kris Faafoi

Section A: Summary problem and proposed approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
Our current regulatory framework around consumer credit is not adequately protecting consumers from harmful or problematic debt. The government is best placed to ensure borrowers are protected from harmful lending practices.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
The recommended changes will enhance the existing consumer credit regulatory regime. They will enable easier enforcement by the regulator without placing an undue burden on lenders.

Section B: Summary impacts: benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
Individual New Zealand borrowers are expected to be the main beneficiaries, via an expected reduction in harm (from reduced predatory and irresponsible lending).

Where do the costs fall?
The most significant costs are: • Businesses (lenders) – moderate increase in compliance costs • Government/Commerce Commission – moderate increase in administration, monitoring and enforcement costs

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
• Reduced access to credit, where this was previously granted in unaffordable or unsuitable circumstances. Moderate to low impact. Mitigated by continuing availability of support from Ministry of Social Development (Work and Income), Whānau Ora and charities. In addition, independent work is underway to increase access to microfinance and other safe forms of credit for vulnerable consumers. However, this support will not necessarily be available or

accessible to all families in need, so there may continue to be service gaps for some vulnerable consumers. The Ministry for Social Development is currently developing a strategy on increasing access to safe credit, with a view to being ready to trial interventions in Q4 2019.

- Increased cost of credit, where costs of compliance are passed on to consumers. Low impact. Additional compliance costs largely flow from proposals that look to strengthen the overall implementation of the intent of the CCCFA, rather than completely new proposals that are a significant departure from existing regulation.
- More 'black market' lending. Low impact. The proposals are geared to support compliance with the existing framework of obligations. Creditors who are wilfully non-compliant with new requirements are unlikely to have been complying with existing legal obligations.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
N/A

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
Broadly, we have a low to medium level of confidence in the evidence base. Quantitative information about the nature and extent of various borrowing, and resulting financial harms is held across hundreds of lenders, and was not accessible to MBIE. The short timeframe for the review did not permit primary research. However, qualitative reports and concerns regarding the key harms have been validated by numerous contributors to the review.

Quality Assurance Reviewing Agency:
Regulatory Impact Assessment Review Panel, Ministry of Business, Innovation and Employment RIARP@mbie.govt.nz
Quality Assurance Assessment:
RIARP Recommendation: Meets
Reviewer Comments and Recommendations:
MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement (RIS) prepared by MBIE. The panel considers that the information and analysis summarised in the RIS meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Executive Summary: Consumer credit regulation review

The proposals in this paper have the overall purpose of protecting the interests of consumers and promoting fair, efficient and transparent markets for credit.

The proposals will enhance the existing consumer credit regulatory regime under the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). The CCCFA was amended in 2015 to introduce new consumer protections and lender obligations. Changes included new lender responsibilities (including requirements to assist borrowers to make informed decisions and enquire into whether borrowers can repay loans), repossession and disclosure requirements, and greater penalties. However, there are still significant concerns about harm to consumers. This is due in part to some regulatory gaps, as well as non-compliance with the regulatory regime.

Problem definition

There is a continued, widespread problem of consumers ending up in unmanageable debt when they are provided with loans that are unaffordable or unsuitable. This seriously impacts their lives and those of their families. Problem debt exacerbates financial hardship and stress, and can contribute to on-going, intergenerational poverty.

The proposals in this paper seek to address the following problems.

High cost of some consumer credit: Some lenders offer small loans over short timeframes, which can have rates of up to 800 per cent per annum. This can lead to financial harm and debt spirals. This is particularly a problem for vulnerable consumers, who may not have access other forms of credit.

Significant levels of non-compliance with existing laws: There appear to be widespread non-compliance amongst some – but not all – lenders. This is particularly the case with requirements to advertise responsibly, undertake assessments of a borrower's ability to repay, and not charge unreasonable fees. Low barriers to entry, a lack of clarity or specificity around CCCFA obligations, weak incentives to comply and insufficient consequences may all be contributing to continued non-compliance and irresponsible behaviour.

Predatory behaviour by mobile traders: Mobile shopping trucks and traders continue to target vulnerable consumers. This generates unaffordable debts. Predatory and irresponsible behaviour, including in relation to the sale of goods on credit, has continued despite concerted monitoring and enforcement activity.

Irresponsible debt collection: When borrowers default on credit, some debt collectors are engaging in deceptive and unreasonable behaviour, demanding unaffordable repayments and imposing excessive charges. Debt collectors are not generally caught by directly subject to the CCCFA.

Proposals

Problem	Proposals	Expected Impact
Excessive cost of some consumer credit agreements ***(pp.10-16)***	Cap Option A: Limit the accumulation of interest and fees to 100% of the original loan principal.	**Benefits:** Limits debt accumulation from a single loan. **Costs:** May reduce access to credit for high risk borrowers, reduce lender revenues, require additional monitoring and enforcement. **Risks and limitations:** Does not address repeat borrowing or general high expenditure on interest or fees.
Irresponsible lending ***(pp.17-22)***	Registration Option A: Simplify process to ban directors from involvement in the credit industry	**Benefits:** Enables more effective and streamlined banning, which deters irresponsible lending. **Costs:** Increased monitoring and enforcement. **Risks and limitations:** More lenders may operate

		underground.
	Registration Option B: Introduce a fit and proper person test in registration of lenders	**Benefits:** Reduces participation of individuals with a history of misconduct/non-compliance. Reduces irresponsible lending. **Costs:** Lender registration fees and administrative costs for government. **Risks and limitations:** May reduce competition and consumer choice in credit providers.
Non-compliance ***(pp.23-34)***	Enforcement Option A: strengthen penalties and enforcement powers for existing obligations	**Benefits:** Increased ease of prosecution and deterrence. **Costs:** Lenders may be more risk averse, raising compliance costs. **Risks and limitations:** N/A
	Enforcement Option B: duty of due diligence for directors and senior managers	**Benefits:** Incentives for directors to ensure adequate compliance systems. Makes enforcement easier. **Costs:** Enforcement costs for Commerce Commission. **Risks and limitations:** May leave room for differing interpretations of obligations.
	Enforcement Option C: substantiation obligation for lenders	**Benefits:** Makes consumer self-enforcement and Commerce Commission action easier. **Costs:** Compliance costs for any lenders who are not already documenting their processes. **Risks and limitations:** N/A
	Responsibility Option A: prescriptive requirements for affordability (established in regulations)	**Benefits:** Improves clarity of law, which potentially improves compliance. Makes enforcement easier. **Costs:** Compliance costs for lenders. **Risks and limitations:** Limits access to credit for some borrowers. Does not address wilful non-compliance.
	Responsibility Option B: limit the ability of lenders to rely on information provided by the borrower	**Benefits:** Strengthens affordability assessments. Makes enforcement action easier. **Costs:** Slight increase in costs for currently irresponsible lenders. **Risks and limitations:** May deter some consumers from applying for credit.
	Responsibility Option C: prescriptive requirements for responsible advertising	**Benefits:** Clarifies expectations around responsible advertising. Makes enforcement easier. **Costs:** Initial system set-up costs. **Risks and limitations:** May not change the behaviour of desperate and vulnerable borrowers.
	Responsibility Option D: require disclosure to be in the same language as advertising	**Benefits:** Improves information disclosure to vulnerable consumers. Reduces predatory lending targeted at vulnerable consumers. **Costs:** Costs for lenders who already advertise in multiple languages. **Risks and limitations:** Lenders may stop advertising in

		other languages.
Continued predatory behaviour by mobile traders *(pp.35-40)*	Scope Option C: Fit and proper person test in registration of mobile traders	**Benefits:** Same as for Registration Option B. As such, it would bar undesirable individuals from operating. **Costs:** Same as for Registration Option B, plus costs associated with mobile traders registering on the FSPR. **Risks and limitations:** Relies on an appropriate definition of mobile traders that doesn't over- or under-capture companies.
	Scope Option F: Strengthen the ability of consumers to require mobile traders to leave their premises	**Benefits:** Gives legal effect to "Do Not Knock" stickers. **Costs:** N/A **Risks and limitations:** Would not apply outside of consumers' premises, such as if the truck shop parked outside the house.
	Scope Option G: Provide a regulation-making power to enable regulations defining which agreements are, or are not, consumer credit contract	**Benefits:** Provides a mechanism to address risks and lack of regulatory clarity arising from more rapid innovation in the credit markets and potential consumer harm from avoidance of CCCFA obligations. **Costs:** No immediate costs. **Risks and limitations:** Specific proposals to define agreements will need careful consideration (and further impact assessment) through the development of regulations to ensure that agreements are not inappropriately captured.
Unreasonable fees *(pp.41-47)*	Fees Option A: require lenders to substantiate the reasonableness of fees	**Benefits:** Makes enforcement easier. Incentivises compliance with reasonable fees requirements. **Costs:** Increased compliance costs for currently non-compliant lenders. **Risks and limitations:** No incentive to reduce cost of business, beyond existing competitive pressure.
Irresponsible debt collection *(pp.48-56)*	Debt collection Option A: increase disclosure requirements at the commencement of debt collection (to be established in regulations)	**Benefits:** Stronger incentives to provide accurate information to debtors. Makes self-enforcement easier. **Costs:** Increased compliance costs for debt collectors not already disclosing key information. **Risks and limitations:** Small risk that some debt collectors will use fraudulent documents.
	Debt collection Option F: Make non-legislative changes to the Responsible lending Code	**Benefits:** Makes clear that lenders have responsible lending obligations during debt collection, which would increase compliance. **Costs:** Compliance costs for currently irresponsible lenders. **Risks and limitations:** The Responsible Lending Code is not legally binding.

Overall impact of the changes

As a package, these changes are intended to reduce problem debt for consumers and resulting consumer harms, such as financial hardship and mental and physical health issues. They will have an overall net impact of enhancing consumer welfare. They seek to achieve this by increasing creditor compliance with existing requirements, enabling more efficient enforcement where requirements are not complied with, and limiting the total cost of credit for people who default on high-cost loans. They also seek to reduce consumer harm from misleading and deceptive behaviour by debt collection agencies.

One consequence may be a tightening of access to credit for the highest risk borrowers, particularly where this was previously being granted in breach of responsible lending requirements. This will be mitigated by the continuing availability of support from Ministry of Social Development (Work and Income), Whānau Ora and charities. Changes underway at MSD regarding access to entitlements will also assist. In addition, independent work is underway to increase access to microfinance and other safe forms of credit for vulnerable consumers. However, this support will not necessarily be available or accessible to all families in need, so there may continue to be service gaps for some vulnerable consumers.

The most significant costs will be compliance costs on lenders, and enforcement costs for government. Additional compliance costs largely flow from proposals that look to strengthen the overall implementation of the intent of the CCCFA, rather than completely new proposals that are a significant departure from existing regulation. This will slightly increase the cost of doing business, which may be passed on to consumers. The Commerce Commission will also incur additional enforcement costs to ensure that the proposals have the intended effect and send a signal to credit markets.

There are many factors which can drive consumers' decisions to seek unaffordable loans, including inadequate incomes. The Government has been working to address social policy issues more generally. In 2017, legislation introducing the Families Package was passed. This initiative is designed to provide targeted additional social assistance to improve incomes for low and middle income families with children and older New Zealanders. The Government has committed to overhauling the welfare system, to ensure it is accessible and fair to all New Zealanders. As part of the overhaul, the Welfare Expert Advisory Group has been established and tasked with undertaking a broad-ranging review of the welfare system.

While the reforms proposed in this document cannot directly reduce rates of poverty in New Zealand, they do aim to stop private sector lending practices which cause or deepen hardship.

Impact Statement: Consumer credit regulation review

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General information

Purpose
The Ministry of Business, Innovation and Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by Cabinet.

Key Limitations or Constraints on Analysis
Much of the analysis of problems in this statement is based on anecdotal evidence from groups of stakeholders on instances of consumer harm, and qualitative assessments of the extent of harm by those stakeholders. There is a lack of national, quantitative data on the activity, practices and problems in the credit markets. For example, we have relatively little information about the prevalence of problems across particular types of lenders. In these situations, MBIE is unable to fully and accurately assess the scale of the problems identified. We have, however, used all available evidence to assess the severity of the problems identified to the extent possible. This analysis has been significantly time constrained – only a few weeks were available between the close of submissions on the discussion paper and finalising a draft impact statement.
Responsible Manager (signature and date):
Authorised by: Jennie Kerr Competition & Consumer Policy Ministry of Business, Innovation and Employment 24 September 2018

Section 1: Regulatory environment and context

1.1 What is the context within which action is proposed?

Consumer credit contracts are financial products that allow individuals to borrow money or defer payment of goods and services. They include housing loans like mortgages, and other consumer finance like credit cards, vehicle loans and personal loans.

Social and market context

Using credit is a normal part of everyday life for many New Zealanders. Reserve Bank of New Zealand data shows that New Zealand households have $161 billion in housing debt, and a further $15 billion in non-housing consumer loans. Of the non-housing consumer debt, $10 billion of this is owed to registered banks, and the rest to non-bank lenders.[1] According to the 2016 National Consumer Survey, over a quarter of all New Zealand consumers (29%) entered into a credit contract in the two years prior.[2]

MBIE's 2018 desk based lenders survey identified 232 lenders who provide credit to consumers. This was comprised of 12 banks, 12 credit unions and building societies, 12 pawnbrokers and 196 finance companies and other lenders. The Commerce Commission Lender Website Review was conducted at a similar point in time, but used a different methodology to identify lenders. It found 340 lenders in total.

Credit enables households to better cope with short-term cash-flow difficulties (for example, unexpected expenses like a car needing repairs), and to smooth out the cost of large purchases. Access to credit is often considered essential to participation in social and economic life.

However, as discussed in the problem definition section below, credit can also give rise to problem debt, and result in harm to consumers.

Legal and regulatory context

Credit Contracts and Consumer Finance Act 2003 (**CCCFA**)

The CCCFA aims to protect the interests of consumers and promote fair, efficient and transparent markets for credit.[3] Significant amendments to the CCCFA came into force on 6 June 2015. Changes included new lender responsibilities (including the Responsible Lending Code), new requirements for repossessions, changes to information disclosure, and greater penalties for some breaches of the CCCFA. The table below shows the current CCCFA obligations.

OBLIGATIONS OF CREDITORS UNDER THE CCCFA
RESPONSIBLE LENDING Lenders are required to act responsibly, including making reasonable inquiries to ensure that a borrower can make payments without suffering unreasonable hardship and assisting borrowers to make informed decisions
PUBLIC DISCLOSURE Publication of standard form contract terms, interest rates and fees
DISCLOSURE TO BORROWERS Initial and ongoing disclosure to borrowers of key information about the credit contract, including loan balances, interest charges, fees, interest rates

[1] RBNZ Household Balance Sheet as at Sep 2016, published May 2017.

[2] This includes a loan, a new credit card, or an agreement to pay something off over time.

[3] s3 Credit Contracts and Consumer Finance Act

CANCELLATION RIGHTS Provides for the cancellation of credit contracts within five working days of disclosure
PROHIBITS UNREASONABLE FEES Most fees charged in addition to the interest rate are required to be cost-based
PROTECTS CONSUMERS FROM UNREASONABLE OR INVASIVE REPOSSESSIONS Regulates the circumstances under which consumer goods may be repossessed

Responsible Lending Code

Because the lender responsibilities are principles-based, the reforms also provided for the creation of the Responsible Lending Code (**the Code**) to provide practical guidance on ways to meet these obligations. The Code is a non-binding, non-exhaustive list of what lenders can do to comply with their legal obligations under the CCCFA. This includes, for example, how lenders should conduct inquiries into the affordability and suitability of credit contracts.

1.2 What regulatory system, or systems, are already in place?

The CCCFA falls within the consumer and commercial regulatory system.[4] The consumer and commercial system aims to promote the long-term interests of consumers by regulating the interactions that businesses and consumers have before, during, and after the point of sale of a good or service. It seeks to ensure that:

- consumers and businesses have the information they need to transact with confidence;
- consumers and businesses are protected from high levels of detriment; and
- consumers and businesses have access to appropriate redress if things go wrong.

Consumer policy often seeks to protect the most vulnerable consumers – those who may have the least amount of bargaining power, and who may have the least amount of resources to devote to accessing the information they need to transact with confidence, complain about problems, and pursue or access redress.

The consumer and commercial system also helps to provide a level playing field for businesses, by ensuring that all businesses understand their obligations towards consumers and that these obligations are taken seriously.

MBIE has the primary responsibility for maintaining, monitoring, evaluating, and improving the system. In doing so, MBIE is directly accountable to the Minister of Commerce and Consumer Affairs. The Commerce Commission is responsible for enforcing consumer and commercial regulation (under both the consumer and commercial system and the competition system) and provides information and guidance to businesses and consumers about the law. A number of non-government consumer organisations provide advice and information to consumers, including Citizens Advice Bureaux, Community Law Centres and Consumer New Zealand.

Has the overall fitness for purpose of the system as a whole been assessed? When, and with what result?

The overall fitness of the system is currently being assessed by MBIE as part of its Regulatory System Review programme.

[4] For more information, see: http://www.mbie.govt.nz/about/our-work/roles-and-responsibilities/regulatory-systems-programme/document-and-image-library/consumer-and-commercial-charter.pdf

1.3 What is the policy problem or opportunity?

For consumer credit markets to work well, consumers need to make informed choices about credit services, and lenders need to compete to provide credit at competitive prices that reflect the risks associated with different types of products and borrowers.

However, the consumer credit market, like other financial markets, has features that challenge its proper functioning. These derive from the complexity of credit products, and the nature of the participants in the market:

- Lenders are usually more sophisticated and informed than borrowers.
- Borrowers face various costs and difficulties in searching for, identifying and negotiating the best credit offers.
- Borrowers are subject to various behavioural biases that limit their motivation to query terms and conditions, and their ability to make optimal decisions. For example, consumers may focus on the short-term implications of a loan (like receiving the loan) and certain loan features (like the initial interest rate) and disregard longer term implications or additional fees.
- Lenders have limited information about borrowers, who may not always have strong incentives to share information about their financial situation, or to repay loans.

Together, these market factors lead to a lack of competitive pressure in parts of credit markets, and consumer vulnerability to poor or uninformed decisions. This generates a risk of irresponsible lending and borrowing and resulting consumer harms.

Harm to vulnerable consumers from consumer lending and other sources of problem debt

At any time, a proportion of the population is at significantly higher risk of making poor consumer decisions. General risk factors include poverty, lower proficiency in English, disability and low literacy and numeracy. These are heightened by financial shocks (like unexpected expenses or loss of income), stress or addiction. A greater proportion of Māori and Pacific people are exposed to some these risk factors (like poverty), and these groups are disproportionately impacted by poor conduct by lenders and problematic debt.

Harms from problematic borrowing and lending decisions can be extremely serious, affecting quality of life for the borrower and their family, as well as their health. They can include spiralling debt and hardship, personal insolvency or bankruptcy[5], significant stress, and associated harm to mental health[6], relationship breakdowns[7], loss of employment[8] and unstable housing.

Harm from over-indebted consumers also places strain on government and community services. Government income support or charitable emergency relief for individuals is committed to debt repayment. Meanwhile, additional government resources are needed to administer bankruptcy and court processes, and to address illness caused or worsened by stress and hardship

There appears to be relatively little data on the extent of problem debt in New Zealand and its contribution to harm.

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[5] Credit contracts are a major contributor to personal insolvency. Thirty-two percent of debtors who entered Summary Instalment Orders in 2016/17 and provided details as to the cause of their insolvency, said excessive use of credit facilities was the most significant cause of insolvency, followed by 'unemployment of loss of income' (28%). Meanwhile, excessive use of credit facilities accounted for 21% of No Asset Procedures in the same period.

[6] https://www.aucklandcitymission.org.nz/wp-content/uploads/2016/05/Auckland-City-Mission-Family100-Speaking-for-Ourselves.pdf (p5)

[7] https://www.aucklandcitymission.org.nz/wp-content/uploads/2016/05/Auckland-City-Mission-Family100-Speaking-for-Ourselves.pdf (p5)

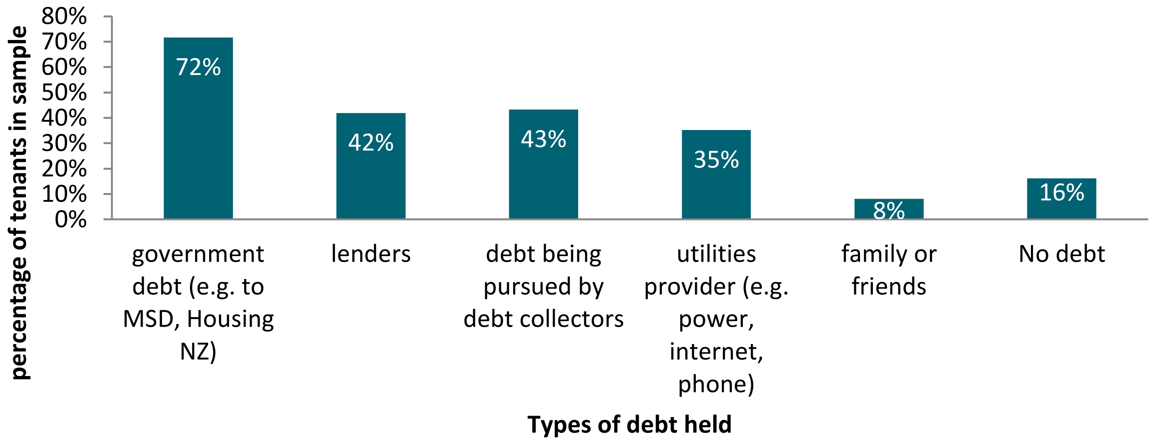
[8] Some security-sensitive jobs such as corrections officers and police officers cannot be held by people undergoing No Asset Procedures.

One social service provider that works with low income families advised that 95% of its client families were carrying unaffordable debt. This represented 900 children and their families (75% of which were Pacific people and 15% Māori).

Two Whānau Ora sub-providers (one working with Pacific people and the other with Māori) advised that most of their client families are struggling with unmanageable debt.

A survey of 74 Māori Housing New Zealand tenants by one of these providers found that they held the types of debt shown in Figure 1. Government debt was most prevalent, with loans and overdue bills also featuring significantly. Most of these tenants face hardship – 89% of tenants said that they run out of food due to lack of money at least sometimes, with many running out of food every week. Most of the survey respondents had less than $5000 of debt, although many had more.

Figure 1 Types of debt held by sample of Housing NZ tenants



Specific problems identified with the regulatory framework for consumer credit

In December 2017 the Minister of Commerce and Consumer Affairs directed MBIE to undertake a review of the 2015 changes to the CCCFA, to assess whether borrowers are better informed, whether predatory and irresponsible lending has reduced, and whether further steps are required to ensure responsible lending, particularly for vulnerable consumers.

To help assess the impact of the reforms, we conducted a desk-based survey of lenders and structured conversations with over 30 stakeholders, followed by a public consultation process. Together, these methods have provided a broad understanding about what is working from the 2015 changes, what is not working, and potential improvements which could be made.

Stakeholders consistently reported that overall, the 2015 responsible lending changes have led to improvements in the information available to consumers, and in lender processes and decision-making.

However, many stakeholders were greatly concerned about continued irresponsible and harmful lending and other issues in the credit markets. These issues were seen to contribute to problem debt and resulting consumer harm.

These problems are further developed in the following sections, but the table below provides a brief summary of the main issues.

WHAT'S NOT WORKING?

Summary of problems

HIGH COST OF SOME CONSUMER CREDIT AGREEMENTS	SIGNIFICANT LEVELS OF NON-COMPLIANCE
Some credit contracts have very high interest rates and fees. This was seen to contribute to unmanageable levels	There is continued irresponsible lending by some lenders, particular in carrying out affordability assessments and in

of debt – particularly where these products were frequently used or borrowers defaulted.	advertising practices. Stakeholders noted that the harm of irresponsible lending falls disproportionately on vulnerable consumers – and in particular, people in hardship.
CONTINUED PREDATORY BEHAVIOUR BY MOBILE TRADERS Mobile shopping trucks and traders making uninvited sales of goods on credit continue to target vulnerable consumers and generate unaffordable debts. Some of their contracts may fall outside the CCCFA.	**CHARGING OF UNREASONABLE FEES** As part of the broader problem of non-compliance, there are a range of concerns about the nature of fees charged, and their seemingly disproportionate amounts.

Stakeholders have also expressed concerns that there are insufficient alternatives to taking on high-cost credit for people who need loans for essentials.

1.4 Are there any constraints on the scope for decision making?

This review has focussed on analysing the effectiveness of the 2015 reforms of the CCCFA, and related issues of responsible lending. It is not a first-principles review of the CCCFA.

In parallel with this work, government, industry, and community agencies are working together to increase vulnerable consumers' access to inclusive banking products and services, emergency savings, microfinance and cars and car finance.

Other government work which will contribute to improved outcomes for vulnerable borrowers includes the work of the Commission for Financial Capability and Ministry for Social Development (including work on Building Financial Capability and access to Work and Income entitlements).

1.5 What do stakeholders think?

Consultation has been undertaken with a range of dispute resolution services, consumer advocates and lenders. Public consultation on the discussion paper occurred between 27 June 2018 and 1 August 2018.

There was a high degree of stakeholder agreement with problems identified, including both consumer advocates and most lenders.

1.6 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

These are set out issues by issue below.

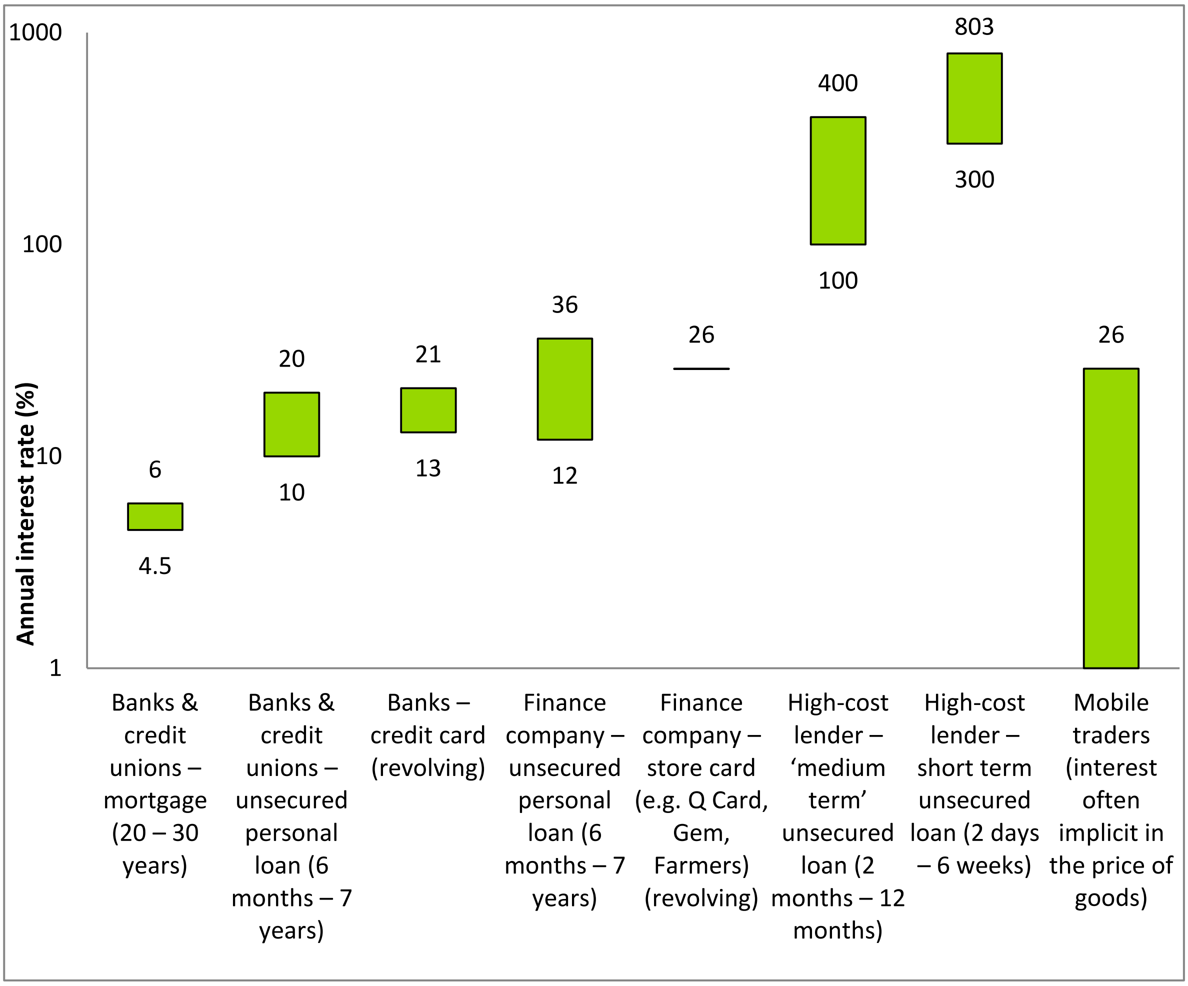
Section A2: Problem definition and objectives: Excessive cost of some consumer credit agreements

A2.1 What is the policy problem or opportunity?

Some lenders offer small loans over short timeframes. These credit products are referred to as 'high cost' on the basis of their high annual interest rates, or when compared against products offered by 'mainstream' lenders such as banks, credit unions and finance companies.

Historically, short-term lenders have provided credit to people who, due to their credit histories, may not qualify for credit elsewhere. This is a large number of consumers – we understand that 30-35% of New Zealand adults have 'impaired' or sub-prime credit scores.[9]

The chart below shows general terms and interest rates (in annualised form) across different types of lending products in New Zealand. The chart shows the very high interest rates charged by high cost lenders – from 100–400% per annum for a 3-12 month loan, to many hundreds of percent interest per annum for a short (under 6-week) loan.



Problems raised with high-cost loans are:

- **Financial harm from frequent use of high-cost loans.** Borrowers who regularly use high-cost loans may make substantial payments in interest and fees, reducing their net incomes and wealth, and making them more vulnerable to financial shocks.
- **Debt spirals.** Consumers who default on high-cost loans or seek loan extensions can end up with unmanageable debt and in financial hardship, even if the original loan was affordable. This is

[9] This estimate was shared by a lender, and is based on data from two credit reporting agencies.

because, if not paid off quickly, high interest rates and fees can result in rapid accumulation of the loan amount.

- **Uncompetitive rates.** Interest rates or fees may be viewed as 'excessive' in the sense that they are much higher than would be expected in an informed, competitive market.

Repeated high-cost loans are a commonly reported problem. This is likely to only affect a minority (possibly a small minority) of high-cost loan borrowers, and particular lenders. For example, one lender's borrowers were observed to take out an average of nine loans each over a two-year period, with some borrowers taking out up to 36 loans.[10] Some lenders have implemented 'stand-down' periods for repeat borrowers to help address these issues.

'Debt spirals' are also commonly reported, and a number of examples have been shared. For example, FSCL provided an example of a person taking out a $175 loan and missing payments; after paying off $330, she still owed $590 from interest, bank dishonour fees ($49) and letter fees ($30) – i.e. the total accumulated to $920, over 5 times the original sum). These issues are likely concentrated in particular high-cost lenders – default rates vary widely across the industry, and a number of major short-term lenders implement caps, so that interest and fees are not charged for more than two months, or beyond a certain multiple of the original loan value.

Uncompetitive rates are evidenced to some extent from the wide range of interest rates charged for similar high-cost loans, although high annualised interest rates are inevitable given the need to recover fixed costs over a short loan term. Weak competition most likely stems from information asymmetries and patterns of borrower behaviour that limit price competition in the high-cost lending industry. In light of the number of lenders and low barriers to entry, there are unlikely to be competition issues relating to market structure, excessive barriers to entry or anti-competitive agreements.

Section A3: Options identification: Excessive cost of some consumer credit agreements

A3.1 What options are available to address the problem?

Three options have been identified to directly address the problems caused by the cost of some consumer credit agreements. These are:

- Cap Option A: limit the accumulation of interest and fees
- Cap Option B: reduce the highest interest rates and limit accumulation of interest and fees
- Cap Option C: set a low interest rate cap to eliminate high-cost lending.

These options have been further refined from consultation. The options are mutually exclusive (although Cap Option B incorporates Cap Option A).

Some other non-regulatory options are being pursued in partnership with industry and community groups, such as the development of community finance that would compete with high-cost lenders, and efforts to improve financial capability across communities.

Cap Option A: Limit the accumulation of interest and fees

As discussed above, a key problem with high interest rates and fees is that consumers who default on high-cost loans, or seek loan extensions, can end up with unmanageable debt and in financial hardship, even if the original loan was affordable. High interest rates and fees result in the rapid accumulation of loans, if they are not paid off quickly.

[10] Commerce Commission data.

Under Cap Option A, interest and fees over the life of the loan would be limited to 100% of the original loan principal. This means that the borrower would repay no more than twice the original loan principal. This option would only apply to high-cost lenders (currently defined as those with an annual interest rate exceeding 50%). We decided on a cap of 100% because as far as we are aware, this is the lowest of the voluntary caps currently applied in the New Zealand lending market.

This option would directly address the problem of defaulting borrowers incurring large debts from a small loan by limiting the accumulation of interest and fees. It would also limit the level of interest and fees on some of the most extreme high-cost credit contracts. However, it would not address issues with frequent use of high-cost loans, nor more general concerns about borrowers entering into contracts with uncompetitive interest rates and fees.

A similar restriction applies in the United Kingdom (since January 2015) and Australia (since July 2013), and some providers of high-cost loans in New Zealand also apply a similar limit voluntarily.

Cap Option B: Reduce the highest interest rates and limit accumulation of interest and fees

Beyond limiting the accumulation of interest and fees, a further step for addressing harms associated with high-cost lending is to directly limit the level of the interest and fees that can be charged.

Under Cap Option B:

- Interest and fees would be limited to 200–300% per annum.
- There would be a prohibition on default interest exceeding the normal interest rate, and a limit on default fees to $30 over the life of the contract.
- The same limits on accumulation of interest and fees would apply as in Option A.

This option would only apply to high-cost lenders.

This option includes the limits in Cap Option A that directly address the problem of defaulting borrowers incurring large debts from a small loan by limiting the accumulation of interest and fees. It would also address more general concerns about borrowers entering into contracts with uncompetitive interest rates and fees. It would partly address issues of borrowers making frequent use of high-cost loans, mostly by pushing lenders to offer longer term, lower cost loans – see the discussion on the impacts of this option in section A4 below.

This option is similar to that used in the United Kingdom since 2015. The US states of Maine, Oregon and Colorado also cap interest and fees at a roughly similar level.

Based on overseas experience, we would expect the interest and fee rate cap to be largely complied with by lenders, and therefore borrowers using high-cost lending services would pay substantially less in interest and fees. This should contribute to lower rates of default and reduced hardship as a result of high-cost lending.

A major concern with Cap Option B is the potential for borrower harm from reduced access to credit, as lenders close and tighten lending criteria or offer less short-term loans. The number of people obtaining high-cost credit reduced in the UK from 2.2 million (over an 18 month period) to 1.3 million. We have little information about likely negative borrower impacts in New Zealand, but there is a risk that they could be significant.

It is possible that the cap could facilitate price coordination, leading some high-cost lenders to raise interest rates up to the level of the cap. It also is possible that the cap could increase illegal lending (from lenders charging higher interest rates), although overseas experience suggests this is a low risk.

Cap Option C: Set a low interest rate cap to eliminate high-cost lending

This option would aim to eliminate high interest rates and fees generally. In doing so, it would seek to address all of the problems related to high-cost lending discussed above, as well as some of the non-compliance issues discussed in section C2.

Under Cap Option C, interest and fees would be aggregated into an equivalent interest rate and capped at a specific rate, between 30% and 50%. This would apply to all lenders providing consumer credit contracts.

Such an interest rate cap would effectively prohibit payday lending and other commercial short-term lending of relatively small amounts of money. In doing so, it would directly address all of the concerns about high-cost lending per se. However, it would have a range of other impacts, discussed in section A4 below.

In the United States, 18 states currently prohibit payday lending or set low interest and fee caps which effectively prohibit payday lending. The Canadian province of Quebec provides similar caps.

The main benefit of Cap Option C is greatly reducing hardship caused directly by high-cost lending. Cap Option C addresses all of the issues identified above of: financial harm from frequent use of high-cost loans, debt spirals and uncompetitive rates. As high-cost lenders are a significant source of irresponsible lending, Cap Option C would thus be expected to reduce levels of irresponsible lending.

The main cost of Cap Option C arises from harm to persons with genuinely short-term cash flow difficulties. Our assessment is that this detriment is likely to be substantial, but we have limited quantitative evidence on its magnitude. Most of the more than 200,000 users of high-cost credit in New Zealand would no longer have access to credit from commercial providers, on the basis that they have low credit scores.[11] The level of detriment would depend on both the proportion of those borrowers who have important short-term cash flow difficulties, and the accessibility of other sources of small grants or loans to meet short-term needs – e.g. through Work and Income and social lending providers.

Other costs of an interest rate cap that prohibits high-cost lending include the closure of high-cost lending businesses, the possibility that the cap may facilitate price coordination, and the possibility that the cap may increase illegal lending, and weaken protections for borrowers using these services.

A3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to the excessive cost of some consumer credit agreements:

- reduce consumer harm from high-cost lending and irresponsible lending;
- consumers can access finance to alleviate genuine short-term financial difficulties ; and
- compliance costs are reasonable

These criteria cover the main costs and benefits of options in this area. There are significant trade-offs between criterion 1 and criteria 2 and 3. Options that restrict high-cost lending are also likely to limit access to finance for consumers who would benefit from that lending – including some facing potential hardship.

A3.3 What other options have been ruled out of scope, or not considered, and why?

The main regulatory option that was not progressed further is a cap on repayments as a share of borrower income, for high-cost loans. This option, when floated by Australia, was considered too blunt (as it does not take account of the borrower’s expenses) and somewhat duplicative of other

[11] This estimate has been extrapolated by MBIE from data provided by a small number of large high-cost lenders. As this is a very limited sample of the market, and we were unable to account for borrowers who are customers of more than one lender, the figure is conservatively low. Customer numbers for these credit products are growing rapidly.

affordability requirements in the CCCFA. It was discontinued prior to the discussion paper.

We have not considered major options that fall outside the Commerce & Consumer Affairs portfolio, such as the overhaul of social welfare arrangements to reduce poverty and provide more effective support to persons in hardship (including the establishment of the Welfare Expert Advisory Group) and work underway to reduce child poverty.

We have also not looked to develop options to improve financial capability, as their impacts on the issues in this discussion paper are likely to be quite limited in the short-medium term. These avenues are being pursued independently of the review of the CCCFA.

Section A4: Impact analysis: Excessive cost of some consumer credit agreements

	No action	Cap Option A (limit the accumulation of interest and fees)	Cap Option B (reduce the highest interest rates and limit accumulation of interest and fees)	Cap Option C (set a low interest rate cap to eliminate high-cost lending)
Reduce consumer harm from high-cost lending and irresponsible lending	**0**	+ Would limit the extent to which borrowers accumulate large debts from a single loan. Would not address problems with repeat borrowing or general high expenditure on interest and fees. Stakeholders noted the risk that this option may cause borrowers to seek replacement loans from other lenders.	+ Borrowers would pay less in interest and fees and have lower default rates. Would also limit the extent to which borrowers accumulate large debts from a single loan.	++ By prohibiting high-cost lending, would be expected to greatly reduce harms from this activity. However, there is a risk that this option would increase illegal lending, resulting in weaker protections for remaining borrowers using these services.
Consumers can access finance to alleviate genuine short-term financial difficulties	**0**	**0** Likely to slightly reduce access to credit, although mainly for the highest risk borrowers and smallest loans.	- Likely to moderately reduce access to credit for higher risk borrowers, as lenders close and tighten lending criteria or offer less short-term loans.	-- Likely to significantly limit access to credit for borrowers with genuinely short-term difficulties but poor credit scores.
Compliance costs are reasonable	**0**	**0** Will reduce revenues of some lenders, and require monitoring and enforcement.	- Many high-cost lenders are likely to close. Would require monitoring and enforcement.	-- Would close all (legally operated) high-cost lenders. Would also require monitoring and enforcement.
Overall assessment	**0**	+ Likely to be a small improvement on the status quo	Unclear if positive or negative - high uncertainty	Unclear if positive or negative - high uncertainty

Key:

++ much better than doing nothing/the status quo
+ better than doing nothing/the status quo
0 about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- - much worse than doing nothing/the status quo

Section A5: Conclusions: Excessive cost of some consumer credit agreements

A5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
Our preferred option is Cap Option A – limiting the accumulation of interest and fees. This option would limit the extent to which borrowers accumulate large debts from a single loan. We would expect that fewer borrowers, particularly the more vulnerable borrowers, would accumulate unmanaged debt and get into financial hardship. Borrowers would pay less in interest and fees overall. It would also reduce the use of business models based on irresponsible lending and generating revenues from borrowers in default. As this option would limit the amount of revenue that affected lenders receive from default interest and default fees, it would make business models based predominantly on these charges less profitable and feasible. This is likely to cause these lenders to alter their loan criteria and business models to reduce default rates, so that they may make fewer unaffordable loans. Although we are confident that it will help to prevent harm to some borrowers in specific circumstances (i.e. debt growing without limit following default), it would be appear to only address a small subset of the harms caused by high-cost lending. The costs, however, in the form of restricting access to credit and costs to business are fairly low. The other two options (Cap Option B and Cap Option C) may have much larger benefits, but also come with significant risks of harm to consumers, due to them restricting access to credit. The uncertainty around the magnitude of the costs and benefits of Cap Option B and Cap Option C further makes them difficult for us to recommend with confidence. Cap Option A was favoured by a range of stakeholders, including a number of finance companies and budgeting services. However, most budgeting services and other major consumer stakeholders considered that it did not go far enough– these stakeholders by and large supported Cap Option C. Banks tended to support Cap Option C also, and were concerned that Cap Option A might apply to some of their credit products. We are confident that the banks' concerns can be effectively dealt with by ensuring the definition of 'high-cost credit contract' does not capture their relatively low-cost credit products.

Section B2: Problem definition and objectives: Irresponsible lenders

B2.1 What is the policy problem or opportunity?
In response to many lenders providing unaffordable or unsuitable loans to vulnerable consumers, the 2015 changes to the CCCFA focussed on introducing new responsible lending requirements. However, consumer stakeholders and submitters have identified continued irresponsible lending practices across all types of lenders, with their reports and Commerce Commission complaints data suggesting problems are particularly concentrated across finance companies and high-cost lenders and among vulnerable consumers. For example, it is common for some lenders to perform only superficial testing of loan affordability, to accept income and expense information provided from borrowers without proper verification and to approve subsequent loans without carrying out affordability checks again. Stakeholders and submitters have also raised that some lenders are also not adequately assisting borrowers to make informed decisions as they are upselling unnecessary new loans or top-ups and having guarantors

signing guarantees that they do not understand. More generally, charging interest and fees on loans some time after default that end up being thousands of dollars more than the principal have also been raised as oppressive and irresponsible.

Low barriers to entry into consumer credit lending, a lack of clarity or specificity around CCCFA obligations, weak incentives to comply with the law and insufficient enforcement consequences for non-compliance with the lender responsibilities may all be contributing to continued irresponsible behaviour by lenders in the market.

We note that as a result of only moderate levels of monitoring and enforcement in the industry, a lot of the evidence of lenders behaving irresponsibly and not complying with the responsible lending principles is anecdotal or based on case studies given by stakeholder or submitters. Other than the complaints data above, we also have relatively little information about the prevalence of problems across different types of lenders in the industry. Stakeholders agreed that most loans are repaid without incident. However, contributions to the review revealed widespread concerns about the harm caused by irresponsible lending, and particularly where interest and fees accumulate quickly.

Section B3: Options identification: Irresponsible lenders

B3.1 What options are available to address the problem?

Registration Option A: Expanded powers to deregister lenders and ban directors from future involvement in the credit industry

Under this option the powers of the Commerce Commission could be expanded to include directing permanent deregistration of lenders and banning of individuals involved in those creditors. The option also aims to improve the ability of the Commerce Commission to ban directors and senior managers of lenders which have contravened the Act, from future involvement in the industry.

Expand the Commission's powers to include ordering deregistration of lenders

The Commerce Commission could be empowered to direct the Registrar of the Financial Service Providers Register (FSPR) to deregister a lender providing consumer credit if it is satisfied that the lender is causing harm in their lending conduct on consumers. This power would work to reduce harm caused by predatory and irresponsible lending by permanently removing creditors that are currently causing harm from the register and thus from operating in the market.

Simplify CCCFA banning orders

We have heard concerns that the threshold for obtaining a banning order against a director or senior manager of a lender may be too high, particularly where the individual has not been shown to have personally breached the Act. This issue arises because generally only the creditor (body corporate) is charged with an offence or a party to civil proceedings, but in practice it is directors and senior managers who are responsible for ensuring that the business complies.

Under this option, section 108 would be amended so that the misconduct which makes a person eligible for a banning order is expanded to include offences against the CCCFA, FTA, sections 217 to 265 of the Crimes Act (relating to crimes against property), the Financial Service Providers (Registration and Dispute Resolution) Act and the Secondhand Dealers and Pawnbrokers Act, or any equivalent overseas legislation. It would also be expanded to include situations where civil pecuniary penalties are incurred or directors' duties breached. Additionally, the provision that may prevent a banning order from being given if the person has no previous convictions (section 108(1A)(a)(ii)) would be deleted to enable orders to be obtained more efficiently.

Registration Option B: Introduce fit and proper person test in registration of lenders

A step to reduce the number of irresponsible lenders from operating would be to require directors and senior managers of consumer credit providers to show they are fit and proper persons, in addition to the existing registration process on the FSPR. This would aim to prevent businesses – led by individuals who are at higher risk of engaging in irresponsible lending – from acting as lenders (rather than waiting for the law to be breached before considering their ongoing fitness to lend).

The test would cover good character and capability assessments with some level of research and investigation by the regulator required. Individuals would have to be re-assessed or re-confirmed periodically to ensure ongoing compliance with the requirement and would have to report changes to their directors and senior managers. If a creditor's directors and senior managers are no longer fit and proper persons, processes for removing their registration will be provided for. The decision would also be subject to appeal.

As a guide for the approximate cost to business for the fit and proper person test, the FMA currently charges around $1,300 per individual for a similar assessment. The application costs/fees involved in the administration of a fit and proper person test would not be used for funding other activities of the regulator and would be a recovery of the costs involved in assessing a fit and proper person application. For an average lender with four directors/senior managers, the approximate total upfront cost of the fit and proper person test to a lender could be around $5,200. As the processes and administration involved in the periodic re-assessment or re-confirmation would be lower than the initial assessment, re-assessment or re-confirmation costs/fees would also be lower.

Registration Option C: A comprehensive creditor licencing regime

A more extensive option is comprehensive licensing for lenders providing consumer credit. This option could build on the fit and proper person test for directors and senior managers proposed in Registration Option B, but include additional requirements that creditors must meet before receiving a licence and being registered on the FSPR. The requirements to obtain a licence under the comprehensive licensing system could be that the regulator is satisfied that—

- The applicant's directors, senior managers, and proposed directors and senior managers are fit and proper persons to hold their respective positions.
- The applicant will have adequate systems and procedures to be a responsible lender and otherwise comply with the CCCFA.
- There is no reason to believe the applicant is likely to contravene obligations under the CCCFA.

Licences could be granted with certain conditions, and the decision would be subject to court appeal.

B3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to irresponsible lending:

- consumers are protected from irresponsible lending;
- legal obligations are clear;
- compliance costs are reasonable; and
- confidence in consumer credit markets.

Criteria 1 and 2 are achieved at the expense of the third cost criterion. The analysis and recommendations of options take this into account so that the extent to which the options address the problem is weighted against their costs. The fourth criteria of confidence in consumer credit markets is more likely to be able to be achieved without necessarily increasing costs and is also positively correlated with whether or not consumers are protected from irresponsible lending.

B3.3 What other options have been ruled out of scope, or not considered, and why?

N/A

Section B4: Impact analysis: Irresponsible lenders

	No action	**Registration option A** (expanded powers to deregister lenders and ban directors from future involvement in the credit industry)	**Registration option B** (introduce fit and proper person test in registration of lenders)	**Registration option C** (a comprehensive creditor licencing regime)
Consumers are protected from irresponsible lending	**0**	+ Improved removal of irresponsible lenders from the market	++ Greater prevention and reduction of irresponsible lenders operating in market by setting bar to entry higher	++ Modest reduction in irresponsible lenders entering and operating as bar and deterrent to entry higher
Legal obligations are clear	**0**	**0** No new legal obligations	- Some new legal obligations for lenders unclear for some time	-- Considerable amounts of new legal obligations for lenders unclear for some time
Confidence in the consumer credit markets	**0**	+ More bans likely to provide greater confidence to market	++ Prevention and removal of current irresponsible lenders provide significant benefits to confidence in the market	++ Prevention and removal of current irresponsible lenders provide significant benefits to confidence in the market
Compliance costs are reasonable	**0**	- Some cost involved to regulator with adjusting to new powers and to irresponsible lenders subject to those powers	-- Moderate costs involved in set up of system and for lenders being assessed. Responsible lenders should pass relatively easily	-- Substantial initial and ongoing costs involved to all parties, including the potential for discouraging entry into the market
Overall assessment	**0**	+ Improvement on status quo	+ Improvement on status quo	- Worse than status quo

Section B5: Conclusions: Irresponsible lending

B5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

We recommend:

- Registration Option A (in part) – only the streamlining of banning order powers
- Registration Option B: Introduce fit and proper person test in registration of lenders

Registration Option A: Expanded powers to deregister lenders and ban directors from future involvement in the credit industry

On balance, we consider that the benefits outweigh the costs for the banning order component of this option. This option would enable more effective and streamlined banning and removal of people from the lending industry. This would lead to a modest reduction in irresponsible lending over time, and a consequent reduction in consumer harm.

The option does not directly increase compliance costs on lenders, although it may result in lenders taking a more risk averse approach to lending (this may or may not be a negative impact). As generally compliant lenders would be very unlikely to be subject to deregistration or banning, we would not expect this option to result in 'over compliance' and associated costs.

Stakeholder views

There was broad support for the proposals as a beneficial extension to the Commerce Commission's enforcement powers, some with caveats on the design of the powers. A few lenders and representative bodies argue that the current powers to prevent involvement in the industry by irresponsible lenders are sufficient. Some also raised concerns around providing the Commerce Commission with the power to deregister and suggested that it would seek deregistration where it was not appropriate to do so. However, such a power to direct deregistration would come with procedural fairness checks and controls.

However, while the Commerce Commission supported streamlining banning orders, it did not support a deregistration power. If parties that the Commerce Commission attempted to be deregistered decided to appeal, there may be significant administrative costs and it may take considerable periods of time to achieve. The Commission was also concerned that directing deregistration of a provider from the FSPR does not preclude that provider from simply transferring their loan business to a new FSPR and continuing to operate.

Registration Option B: Introduce fit and proper person test in registration of lenders

A fit and proper person test could reduce the participation in the credit markets of individuals who have a history of misconduct, dishonesty or involvement in businesses that show a lack of regard for compliance. This should reduce and help to prevent irresponsible lending within the consumer credit markets.

This option imposes moderate direct costs on some lenders (from higher registration fees) and also indirect administrative costs, with the process for a lender appointing new directors or senior managers also becoming more onerous. Lenders may pass the additional compliance costs onto consumers in some form e.g. higher interest rates or fees.

The greater requirements for operating in the market may reduce the number of credit providers in the market, reducing consumer choice and potentially lessening competition. Some lenders, who do not meet the new requirements, will simply operate unregistered.

On balance, the benefit of reducing irresponsible lending outweighs the costs on lenders.

Stakeholder views

The majority of stakeholders and submitters who are – or who represent borrowers – argued for greater registration or licensing requirements for consumer credit providers. Submissions and feedback from stakeholders mostly supported the creation of a fit and proper person test for consumer credit providers along the lines of that used by the Financial Markets Authority and overseas jurisdictions. This was seen as a logical way to raise the bar for entry in the market and prevent undesirable and irresponsible individuals from lending. Slightly fewer submitters were supportive of a comprehensive creditor licensing regime as a result of the significant costs involved and the potential for it to have distorting effects on the makeup and willingness of lenders to participate in the credit markets.

Some submitters did highlight that a fit and proper test would need to require useful information from lenders' directors and senior managers above and beyond what is already required in order to be a useful improvement on the status quo. In a similar way, a balance would also need to be struck in order to set the bar high enough to prevent irresponsible lenders from operating but not so high that competition is stifled in the industry.

Section C2: Problem definition and objectives: Non-compliant lending

C2.1 What is the policy problem or opportunity?

Across credit markets, there appear to be inconsistent levels of compliance with existing legislative requirements, which results in irresponsible lending by some lenders. Specific areas of significant non-compliance which we are aware of are:

- carrying out affordability assessments; and
- advertising practices.

These areas have been drawn to our attention through feedback from lenders and consumer advocates, such as budget advisers who see evidence of these problems in their work. Some stakeholders have also provided us with case studies or told us about situations where lenders did not appear to comply with responsible lending requirements. MBIE's desk-based study of lenders also found that a significant number of websites and advertising by lenders do not display the required information. When lenders do not comply with their legal obligations to lend responsibly, there is a greater risk of harm to borrowers.

In some cases, the underlying cause of the problem of non-compliance may be a lack of clarity or understanding on the part of a lender about their CCCFA obligations. Another underlying cause of non-compliance is that there are relatively weak incentives for lenders to comply with some CCCFA obligations. We have categorised these root causes of the problem below.

Lack of incentives for lenders to comply

Under the status quo, there are no penalties for breaches of the lender responsibilities. The courts can order compensation for any loss to borrowers, and issue injunctions, but there are no offences or civil pecuniary penalties. The lack of penalties means there are weak incentives to comply.

Unlike some other financial markets regimes, penalties and other liability across the CCCFA sit almost exclusively with the creditor and other bodies corporate with limited liability. This means that duties and incentives on directors and senior managers to encourage their organisations to comply with the CCCFA can be relatively weak.

Lack of clarity about principles-based legislation

The Responsible Lending Code (the Code) made under the CCCFA provides guidance on how to satisfy the responsible lending requirements in the CCCFA. The CCCFA provides that evidence of a lender's compliance with the provisions of the Code is to be treated as evidence of compliance with the lender responsibility principles. The Code is intended to make it easier for lenders to determine what their obligations are and how to meet them. However, the Code is not binding, meaning that it does not hold lenders to account if they do not behave exactly as specified in the Code's guidance. This is because lenders may be able to satisfy the lender responsibility principles in other ways not mentioned in the Code.

The principles-based nature of the requirements in the CCCFA and its non-binding nature have been identified by stakeholders as contributing to problems with non-compliance. When legal obligations are not clear, they can be difficult to apply and for the regulator to enforce.

Section C3: Options identification: Non-compliant lending

C3.1 What options are available to address the problem?

The enforcement options address the lack of incentives for lenders to comply with the legislation, while the responsibility options address the lack of clarity about principles-based legislation. Many of the Enforcement and Responsibility options can be implemented in combination; in particular, the increased penalties under Option A would best be implemented alongside clearer legal obligations.

Enforcement Option A: Strengthen penalties and enforcement powers for existing obligations

This option would involve a combination of measures to strengthen penalties and enforcement powers for existing obligations. It would introduce civil pecuniary penalties, statutory damages and expanded injunctive relief powers for the Commerce Commission.

Civil pecuniary penalties

Civil pecuniary penalties would provide stronger incentives for creditors to comply with the lender responsibility principles. This would help to address the problem of non-compliance by providing a greater deterrent for lenders and a greater incentive for the regulator to take enforcement action.

Statutory damages

Statutory damages would make it easier for borrowers to claim compensation where the lender responsibility principles were breached. This would provide a greater incentive for lenders to comply with the requirements.

Where lending has been made in breach of responsible lending requirements, a standard level of statutory damages would be paid equal to the interest and fees that had already been charged. If the amount of statutory damages is less than $200, the amount to be paid would be $200, to ensure there are appropriate consequences. No further interest and fees could be charged on the loan. The court could also order that payment obligations under the credit contract be amended to provide for affordable repayment of the principal amount of the loan.

Expanded injunctive relief

If a lender has breached or is likely to breach the CCCFA, the Commerce Commission would be able to seek injunctions for the purpose of ensuring that the lender is compliant. For example, the court could temporarily prohibit the lender from undertaking further lending, require a lender to obtain and scrutinise bank statements from a borrower before entering into a loan, require a lender to include a warning in advertising of high-cost loans, or require a lender to advise a borrower if lower cost loan types might be available elsewhere.

Enforcement Option B: Duties for directors and senior managers

Directors and senior managers would be subject to duties of due diligence to ensure that the creditor complies with its CCCFA obligations.

Directors could fulfil their duties by ensuring that the creditor has adequate policies for compliance with the CCCFA, and adequate systems for implementing those policies and detecting breaches.

Senior managers would also have duties because they have direct oversight of lending decisions and other day-to-day operations. Senior managers, and directors with more direct involvement in the day-to-day management of the creditor, would fulfil their duties by implementing appropriate systems themselves, ensuring that staff are adequately trained, regularly checking compliance, and taking corrective action where necessary.

Duties of due diligence would be similar to directors' duties in other legislation such as the Health and Safety at Work Act 2015. Relevant case law may be applicable.

Enforcement Option C: Substantiation obligation for lenders

This option would involve creating a requirement that lenders must substantiate their affordability and suitability assessments, and supply a copy on request to the borrower (or their agent) or the Commerce Commission. This would require lenders to document their assessment processes and the evidence relied upon, and would put the burden on lenders to proactively demonstrate that they are conducting all the necessary inquiries.

Lenders could be required to provide the substantiation within a reasonable timeframe such as 10 working days. Where responsible lenders carry out the assessments anyway, identifying and providing this evidence should not take an unreasonable amount of time.

Responsibility Option A: Prescriptive requirements for affordability and suitability

Under this option, mandatory minimum standards would be introduced for some or all types of lenders and loans to assess affordability and suitability of loans in accordance with a defined procedure. Lenders would be required to calculate a borrower's uncommitted income, which would be based on information verified by a review of bank statements and other documentation. This would address the lack of clarity about how to comply with the principles-based legislation, which we have heard is contributing to non-compliance.

This option would be implemented through a new regulation-making power to prescribe how lenders or classes of lenders must satisfy the requirements under section 9C(3)(a).

Responsibility Option B: Limit ability of lenders to rely on information provided by the borrower

Section 9C(7) of the CCCFA provides that for affordability and suitability requirements, "the lender may rely on information provided by the borrower or guarantor unless the lender has reasonable grounds to believe the information is not reliable". The threshold of "reasonable grounds" is high, and in practice this means that lenders are permitted to accept borrower statements about income and expenses at face value, unless they are inconsistent with other information the lender holds about the borrower, or are unrealistic. This is likely to be a barrier to requiring lenders to undertake reasonable inquiries to assess the affordability of repayments.

This option would remove this provision. This would mean that lenders would need to obtain more objective verification of key borrower information, where it was warranted as part of undertaking "reasonable inquiries". For example, lenders may need to obtain payslips or bank account transactions to verify income and fixed financial commitments, given that this is among the most important borrower information.

Responsibility Option C: Prescriptive requirements for responsible advertising

Under this option, the current Responsible Lending Code guidance for advertising would be made binding, with any necessary or desirable modifications. A key feature would be making it mandatory for high-cost lenders to include a warning about high-cost credit, and for lenders to advertise their annual interest rate. The requirements would also specifically address direct marketing to borrowers. The technical detail of this would be prescribed through regulations, with a new regulation-making power created in the Act to empower them.

Responsibility Option D: Require disclosure to be in the same language as advertising

Under this option, there would be a mandatory requirement that disclosure statements be provided in the language that the borrower is most comfortable communicating in, if the lender advertised in that language. This change would aim to assist borrowers in making an informed decision.

The option would need to clearly distinguish what constitutes promotional material in another language, to avoid capturing support material from a community organisation providing financial support or translations in other languages.

C3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to non-compliant lending:

- consumers are protected from irresponsible lending;
- lenders comply with their existing obligations;
- legal obligations are clear;
- compliance costs are reasonable; and
- confidence in consumer credit markets.

The first three criteria will generally be achieved at the expense of the criterion that relates to minimising additional costs. The discussion of the options and our overall recommendations take this into account, so that the extent to which options will address the problem is weighed against their costs.

C3.3 What other options have been ruled out of scope, or not considered, and why?

The following options have not been given further consideration, for the reasons set out below.

Creating a criminal offence for a breach of the responsible lending requirements

A criminal offence would have a higher burden of proof, which may be more appropriate for significant financial penalties. However, given that creditors are almost all bodies corporate, there may be little practical difference in the effect of receiving a conviction and fine compared to a civil pecuniary penalty. It may also be less appropriate to attach a criminal offence to principle-based law, as this is less certain than a straightforward offence. This would also increase the costs of enforcement, which would not likely increase the amount of enforcement action taken, and which would therefore pose less of a deterrent to irresponsible lending.

Deem directors strictly liable for breaches of legislation by the creditor

This option would deem directors to be liable for breaches by the creditor, and provide defences. It would increase the personal liability of directors compared to the directors' duties option, and therefore increase the likelihood of directors taking steps to ensure the creditor is compliant. However, the significant increase in personal liability could make directors even more risk-averse, driving up compliance costs, and making them even less likely to want to take on governance roles.

Guidance and education

This option would be non-regulatory and relatively low-cost. However, it would only have effect for those lenders who want to comply with the law, but don't know how. It does not address the main problem areas of non-compliance (those lenders who don't care to comply).

Automatic referral if in default

This option would involve an automatic referral to an approved dispute resolution scheme or the Commerce Commission when a borrower defaults on a loan. The scheme or regulator would then examine whether the loan had been given in a responsible manner. This option would overburden the dispute resolution schemes and/or the regulator, making it time-consuming and costly and overall impractical to implement. This option also does not take into account the circumstances of default (e.g. a borrower may have defaulted on a loan because their financial circumstances have suddenly changed) or allow the lender to address the default by taking into account the borrower's hardship and adjusting the repayment plan.

Section C4: Impact analysis: Enforcement

	No action	**Enforcement Option A** (strengthen penalties and enforcement powers for existing obligations)	**Enforcement Option B** (duties for directors and senior managers)	**Enforcement Option C** (substantiation obligation for lenders)
Consumers are protected from irresponsible lending	**0**	++ Deterrent effect means more lenders will lend responsibly, and consumers are protected	+ Incentives to implement compliance systems means more responsible lending to consumers	+ Provides a deterrent to lending irresponsibly to inappropriate borrowers
Lenders comply with their existing obligations	**0**	++ Provides significant deterrent, which is likely to reduce non-compliance	+ Introduces incentives for directors and senior managers to oversee compliance	+ Provides a deterrent to not carrying out/documenting assessments
Legal obligations are clear	**0**	**0** No change in legal obligations	- Duties are principles-based	- Involves a change to lenders legal obligations
Compliance costs for lenders are reasonable	**0**	**0** No additional costs for lenders	- Some increase in compliance costs and liability insurance for lenders, and increase in enforcement costs for Commission	- Some compliance costs on lenders not already documenting assessments and where requests are made for substantiation (likely to be low)
Confidence in the consumer credit markets	**0**	++ Provides confidence that serious breaches will incur serious penalties	+ Provides confidence that persons responsible for creditors are invested in compliance	+ Provides confidence that lenders will sufficiently carry out and document assessments
Overall assessment	**0**	++ Moderate improvement on status quo	+ Improvement on status quo	+ Improvement on status quo

Section C4: Impact analysis: Responsibility

	No action	**Responsibility Option A** (prescriptive requirements for affordability and suitability)	**Responsibility Option B** (limit ability of lenders to rely on information provided by the borrower)	**Responsibility Option C** (prescriptive requirements for responsible advertising)	**Responsibility Option D** (require disclosure to be in the same language as advertising)
Consumers are protected from irresponsible lending	0	++ Makes it less likely that borrowers will be given unaffordable loans	+ Fewer lenders are likely to give unaffordable loans if they have verified information to more accurately assess affordability	++ Consumers are less likely to be exposed to irresponsible advertising, and will have more upfront information about credit products	++ Lenders are less likely to target certain consumers without disclosing information in a way they can understand
Reduces non-compliance	0	+ Makes enforcement action easier, which will deter non-compliance	+ Makes enforcement action easier, which will deter non-compliance	+ Makes enforcement action easier, which will deter non-compliance	+ Makes enforcement action easier, which will deter non-compliance
Legal obligations are clear	0	++ Provides prescriptive legal obligations	+ Clarifies that lenders must verify information provided by borrowers	++ Provides prescriptive legal obligations	++ Provides prescriptive legal obligations
Compliance costs are reasonable	0	-- Some lenders will incur compliance costs and some consumers will be denied loans	- Some lenders not currently verifying information will incur costs	- Some lenders will incur costs to the extent that they are not already complying with best practice	- Some lenders will incur costs to the extent that they are not already complying with best practice
Confidence in the consumer credit markets	0	+ Promotes confidence that lending is undertaken responsibly, but some consumers may be less confident that the market will provide them access to credit	+ Promotes confidence that lending is undertaken responsibly	++ Promotes confidence as consumers will have access to information to help them understand and compare credit products	++ Promotes confidence as consumers will have access to information to help them understand credit products
Overall assessment	0	+ Improvement on status quo	+ Improvement on status quo	+ Improvement on status quo	+ Improvement on status quo

Section C5: Conclusions: Non-compliant lending

C5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

We recommend the following options:

- Enforcement Option A: Strengthen penalties and enforcement powers for existing obligations
- Enforcement Option B: Duties for directors and senior managers
- Enforcement Option C: Substantiation obligation for lenders
- Responsibility Option A: Prescriptive requirements for affordability
- Responsibility Option B: Limit ability of lenders to rely on information provided by the borrower
- Responsibility Option C: Prescriptive requirements for responsible advertising
- Responsibility Option D: require disclosure to be in the same language as advertising.

We recommend adopting the requirement for creditors to have to work with consumers' advocates if asked to do so as guidance in the Responsible Lending Code, rather than making it a statutory requirement.

Enforcement Option A: Strengthen penalties and enforcement powers for existing obligations

Overall we consider that the benefits outweigh the costs for this option. It would increase incentives for lenders to comply with the lender responsibilities, and would therefore be likely to reduce non-compliance and protect consumers from irresponsible lending. We would expect this proposal to have minimal costs, the most significant of which will be indirect compliance costs on lenders, which may be incurred to bring them up to existing expectations so that they avoid incurring penalties.

The effectiveness of this proposal in increasing confidence in consumer credit markets depends on enforcement action being taken to send a signal to the industry that there is a real threat of significant financial penalties. Furthermore, more serious penalties for a breach of responsible lending are possibly best implemented alongside clearer legal obligations, which could take the form of more prescriptive requirements for fulfilling those responsibilities. Options for introducing more prescriptive requirements are discussed further below.

Stakeholder views

Most stakeholders supported strengthening the incentives for lenders to comply by expanding penalties, statutory damages and injunctions. A handful of lenders opposed the proposal, on the grounds that existing penalties are sufficient and that more enforcement, rather than greater penalties, is needed to ensure compliance.

Enforcement Option B: Duties for directors and senior managers

Duties of due diligence for directors would increase incentives on directors to ensure the creditor is compliant, and reduce the ability of non-compliant creditors to 'regenerate' as new creditors, with the same directors in place. Duties placed on senior managers, meanwhile, would target duties at persons whose position allows them to exercise significant influence over the management or administration of the creditor.

Due diligence regarding responsible lending and broader compliance with the CCCFA is appropriate, and should be a matter of course for responsible lenders. This is because irresponsible lending is a financial risk to the business, but also because of the serious harm to borrowers and their families, and the reputation of the creditor caused by problem debt.

We think it is likely that the duties will have an impact on making directors and senior managers take more notice of the creditor's compliance obligations, and support a compliance culture. This is based on the effect that similar duties in health and safety at work and financial markets legislation appear to have had on compliance culture in organisations.

Overall this option is likely to slightly reduce non-compliance and therefore have a small impact in protecting consumers from irresponsible lending. There would be some additional costs, of enforcement for the regulator, as well as compliance costs and indirect costs in terms of personal liability insurance for directors and senior managers. However, we do not expect these to be significant. Therefore, we consider that the potential benefits of increased incentives for compliance outweigh the potential compliance and personal liability costs.

Stakeholder views

The majority of stakeholders supported this proposal. They particularly supported extending the duties to senior managers, as these are the people more likely to oversee responsible lending decisions and who are responsible for the day-to-day operations of a creditor.

Some stakeholders emphasised the need for any directors' duties to be clearly spelled out, so that expectations are clear. The Commerce Commission stated that each set of duties should be described otherwise this will create ambiguity and enforcement difficulty.[12]

Enforcement Option C: Substantiation obligation for lenders

Requiring that lenders be able to substantiate their assessments benefits both the borrower and the lender by ensuring the credit is appropriate and affordable and by serving as evidence of the lender's compliance. The option will also assist borrower and advocates to take their own action as it can at times be difficult for them to obtain relevant information from lenders.

Keeping records of assessments is a responsible practice as it substantiates a borrower's ability to meet the loan repayments and obligations and indicates that the lender has carried out an assessment of the suitability/affordability of the loan for the borrower.

While some requests may be made for the substantiation documents, these are likely to be low and requested where there is a need for proving that the assessments took place. We expect that most responsible and compliant lenders already document these assessments and that as a result the costs of keeping such records will fall on irresponsible lenders for whom documenting this information should be a focus for ensuring their own compliance and the rights of borrowers are met. Given this, we expect that the benefits in terms of protecting consumers outweigh the costs for lenders of substantiating information.

Stakeholder views

The majority of submitters and stakeholders were in favour of requiring lenders to substantiate their assessments (i.e. keep records) and provide them on request. Some submitters discussed the important point that such a requirement would do little to improve compliance without sufficient and effective enforcement of non-compliance.

Responsibility Option A: Prescriptive requirements for affordability

The key benefit is that clearer legal obligations are likely to make non-compliance easier to identify and prove, and therefore make enforcement easier. Non-compliance is likely to decrease to some extent, with the flow-on effect of more consumers being protected from irresponsible lending. This option is likely to slightly increase confidence in consumer credit markets.

There are some compliance costs for lenders, particularly those who are not currently compliant.

[12] 074 – Commerce Commission

There may also be costs for borrowers, in that some of them may be declined loans and some may take longer to have their loans approved. However overall the benefits of this option are likely to be more widespread and positively impact a greater number of borrowers than those who would be negatively impacted by greater compliance with responsible lending. Therefore, we consider that the benefits outweigh the costs for this option.

Stakeholder views

Most consumer advocates, consumers and the Commerce Commission supported more prescriptive affordability assessments. Many submitters thought that minimum standards should apply to all types of lenders and loans. However, different types of loans would need different levels of affordability assessments.

Some lenders opposed prescriptive requirements, preferring more guidance rather than inflexible rules. Guidance is provided in the Code already. However, because there is anecdotal evidence from stakeholders that some lenders are not complying with this guidance, arguably prescriptive requirements are likely to make non-compliant lenders take more notice of their legal obligations.

Responsibility Option B: Limit ability of lenders to rely on information provided by the borrower

This option would promote more reasonable enquiries into the affordability of credit, which would increase compliance with responsible lending and help to protect consumers from irresponsible lending. It would probably have a small impact on reducing irresponsible lending across the industry, as we would expect most lenders to already be verifying information. However, it may increase compliance in the segment of the industry that is not currently compliant, by removing a provision that makes expectations around verifying information unclear. There will be some costs for lenders in having to take steps to verify information, but these are likely to be minimal across the industry as we would expect most lenders to already be verifying information as part of undertaking reasonable enquiries. These costs are outweighed by the greater benefits from more responsible lending and easier enforcement.

This option could work alongside Enforcement Option C, which would mean that lenders will have to substantiate that they have taken steps to verify information if it is necessary as part of undertaking reasonable inquiries.

Stakeholder views

The majority of submitters who commented on this proposal were in support. These submitters agreed that lenders should verify the information provided by a borrower, as borrowers have incentives to present information in a way that supports their application.

A number of lenders were opposed, citing the additional costs and processing times for lenders, as well as allowing the borrower to avoid the responsibility of answering questions truthfully.

Responsibility Option C: Prescriptive requirements for responsible advertising

In making legal obligations clearer, this option has a greater chance of deterring non-compliance compared to the status quo. There may be some costs for lenders if they have to review and change any current advertising practices, but we would not expect these to be significant. There may be changes to some systems and processes of compliant lenders to give them greater confidence about their ongoing compliance with the advertising requirements. However, we have not been able to accurately assess the additional compliance costs that such a change would likely impose across the industry.

Overall, this option is likely to increase consumer confidence in consumer credit markets, as they are likely to be able to better understand and compare credit products. We consider that the benefits from responsible advertising to support informed decision-making outweigh the potential compliance costs to lenders of this option.

Stakeholder views

Some lenders commented that the critical information such as interest rates should be mandatory in all advertising. However, there should be different guidelines for different media.

The Association of New Zealand Advertisers opposed prescriptive requirements, arguing that additional costs should not be imposed on lenders who are already responsible. It said that it sees no evidence that responsible lenders are not compliant.[13] However, MBIE's desk-based study identified that there were high levels of non-compliance with the Code's guidance around advertising. We would not expect currently compliant lenders to bear significant costs.

Some submitters suggested that more rules were needed specifically around direct marketing to borrowers. The Commerce Commission suggested that the rules could address direct advertising to borrowers that are in default, repeat direct advertising, and advertising to borrowers who have already requested that they not receive any further offers.[14] We suggest that more prescriptive rules around direct marketing could be added as part of mandatory advertising requirements.

Responsibility Option D: require disclosure to be in the same language as advertising

This proposal makes legal obligations clearer, which is likely to increase compliance and make enforcement easier. It would help to ensure that the level of assistance received by vulnerable consumers would at least match that of other consumers, and support more informed decision-making. This proposal will reduce incentives for predatory lending that is targeted at vulnerable consumers who may not understand contractual terms. Costs will only be incurred by the small segment of the industry that chooses to target their marketing at specific ethnic groups by advertising in other languages.

Overall this option would have a greater effect in deterring non-compliance and protecting consumers from irresponsible lending compared to the status quo. This is expected to outweigh the minor compliance costs. We estimate that the proposal is likely to only benefit a small number of consumers however; as we understand that few lenders choose to advertise in languages other than English.

Stakeholder views

Most submitters supported this proposal, even some lenders who opposed more prescriptive advertising requirements in general. Some lenders appear to have misunderstood the proposal. They opposed it on the basis that lenders would incur significant costs if they were required to provide disclosure in a number of languages. However, the proposal would only require this of lenders who choose to advertise in other languages.

[13] 027 – Association of New Zealand Advertisers

[14] 074 – Commerce Commission

Section D2: Problem definition and objectives: Continued predatory behaviour by mobile traders

D2.1 What is the policy problem or opportunity?

Mobile traders (for the purposes of the review) are businesses that do not have fixed retail premises and sell goods predominantly or exclusively on credit or other deferred payment terms. Some of these traders operate mobile shops, usually from trucks, while others employ sales staff who sell goods door-to-door using catalogues and brochures. Where we refer to mobile traders, we are not referring to traders who sell goods where payment is made at the point of purchase (such as coffee, ice cream, or fast food trucks), or where the trader is offering services, utilities or seeking charitable contributions.

Mobile traders are often lenders for the purposes of the CCCFA, where they sell goods or services through consumer credit contracts. However, some mobile traders do not fall within the CCCFA, such as where payment for the good is made in instalments, but does not involve interest charges, credit fees, or security interest (but may involve default fees).

Stakeholders commonly raised the following concerns about mobile traders:

- **The high cost of purchasing goods with some mobile traders.** The Commerce Commission's investigation found that many products are sold at prices that are significantly higher than the cash prices for a comparable product purchased from a mainstream retailer. This reflects the costs of what is effectively a loan being incorporated into the upfront price, rather than being charged explicitly as interest or credit fees.
- **Predatory and irresponsible behaviour.** For example, according to the Commerce Commission, some mobile traders are engaging in the following conduct:
  - using terms in contracts to ensure continued payment, such as obtaining multiple signed direct debit forms
  - having obscure terms in the contract that mean that customer payments continue after the item is fully paid, to build an account credit
  - utilising refund policies which require a home visit (and for which the customer is charged a home visit fee) prior to refund
  - not allowing customers to exercise their statutory or contractual rights to cancel their agreements
  - failing to make prompt and full refunds
  - retaining the money paid by customers who stop making payments, despite no goods having been supplied to the customer.

Stakeholders have indicated that these problems have continued, despite concerted monitoring and enforcement activity by the Commerce Commission. This suggests that further consideration of law changes may be warranted, in addition to continued enforcement of the existing law.

Section D3: Options identification: Continued predatory behaviour by mobile traders

D3.1 What options are available to address the problem?

Scope Option A: Include credit contracts that charge default fees in the definition of consumer credit contract

Under this option, contracts that involved default fees would be added to the definition of a consumer credit contract under the CCCFA. Currently, to be a "consumer credit contract", a credit contract must include interest charges, credit fees or security interests. This means that credit contracts with default fees would be subject to the requirements of the CCCFA (provided that they met the other criteria of the definition).

Scope Option B: Prohibit the price of goods or services sold on credit from exceeding the cash price

Under this option, the CCCFA would prohibit credit sales of personal, household and domestic goods and services by mobile traders where the price of the goods (excluding interest and fees) exceeds the cash price of the goods or services. The cash price would be defined as the lesser of:

- the lowest price at which a person could have purchased those goods or services from the supplier, on the basis of payment in full at the time the contract was made, or
- the fair market value of those goods or services at the time the contract was made.

Scope Option C: Fit and proper person test in registration of all mobile traders

This option would involve applying Registration option B to all mobile traders. It would mean that directors and senior managers of mobile trader businesses would need to demonstrate that they are fit and proper persons, including those who are not creditors under the CCCFA. To facilitate this, the definition of a financial service provider could be extended to include mobile traders, who would be required to register on the Financial Service Providers Register. The CCCFA would provide that mobile traders must not register on the FSPR unless they have passed a fit and proper person test. This option could be implemented alongside Registration option B, or instead of it.

Scope Option D: Comprehensive mobile trader licensing regime

This option would involve applying Registration option C to all mobile traders. This would mean that all mobile traders would be subject to a comprehensive licensing regime, including those who are not creditors under the CCCFA. This could be done alongside Registration option C, or instead of it.

Scope Option E: Ban door-to-door sale of goods on deferred payment terms

This option would involve banning the sale of goods by mobile traders entirely, unless full payment is made at the point of purchase.

Scope Option F: Strengthen ability of consumers to require mobile traders to leave their premises

This option would involve strengthening the ability of consumers to require mobile traders to leave or not enter their property, including by using stickers such as the 'Do Not Knock' stickers that are currently distributed by Consumer New Zealand.

It would involve a targeted amendment to the Fair Trading Act's provisions relating to uninvited direct sales (defined as the supply of goods or services with a value of more than $100 to a consumer at their home or workplace). The Act would explicitly provide that any person engaging in an uninvited direct sale must leave the premises immediately if directed. It would also specify that a direction may be made in written form (such as through a sticker), and does not need to specifically identify the person being required to leave the premises. It would be an offence to enter or remain on a property contrary to a request.

Separate to the law change, MBIE could work with Consumer New Zealand or another organisation to facilitate wider distribution of 'Do Not Knock' (or equivalent) stickers to households in areas targeted by mobile traders.

Scope Option G: Provide a regulation-making power to declare that agreements are, or are not, consumer credit contracts

Under this option, regulation-making powers could be introduced that would enable the Minister, through regulations, to declare that particular types of agreements were, or were not, consumer credit contracts, and to specify who the creditors were under an agreement. This would allow the scope of the CCCFA to be adjusted to address harms that arise from new, unregulated products in future. These powers could be used to address avoidance of the CCCFA, and also to clarify the treatment of particular credit products (for example, to clarify that a new product is not a consumer credit contract). These powers would be similar to the designation power the FMA has under the Financial Markets Conduct Act. This enables the FMA to declare that a product is a regulated financial product and also to declare that product is not a regulated financial product.

D3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to mobile traders:

- consumers are protected from irresponsible lending practices;
- lenders comply with their existing obligations;
- consumers can access finance to alleviate genuine short-term financial difficulties;
- legal obligations are clear; and
- compliance costs are reasonable.

Generally, there are some trade-offs between:

- criterion 1, and criterion 3; and
- criteria 1-2, and criterion 5.

All criteria are important. However, criteria 1 and 2 are weighted most highly.

D3.3 What other options have been ruled out of scope, or not considered, and why?

There are several options that we have not considered in any detail. Some of these were suggested by submitters and include:

- mandatory affordability assessments by all mobile traders
- requiring mobile traders to provide goods immediately, rather than under layby-type structures
- requiring a credit check before a good can be sold,
- setting a maximum percentage mark-up at which goods may be sold by mobile traders over and above leading retailers, and publish this limit

- requiring mobile traders to note on their website, in advance of visiting an area, when and where they will visit, and place restrictions on how often a community can be visited
- prohibit unconscionable conduct generally, to address poor behaviour by mobile traders.

Some of these are not considered in this document because we do not consider them to be feasible or desirable. Others are relatively similar to options we have considered, currently already in place in some areas, or under local government regulations.

Section D4: Impact analysis: Continued predatory behaviour by mobile traders

	No action	Scope Option A (include credit contracts that charge default fees in the definition of consumer credit contract)	Scope Option B (prohibit the price of goods or services sold on credit from exceeding the cash price)	Scope Option C (fit and proper person test in registration of mobile traders)	Scope Option D (comprehensive mobile trader licensing regime)	Scope Option E (ban door-to-door sale of goods on deferred payment terms)	Scope Option F (strengthen ability of consumers to require mobile traders to leave their premises)	Scope Option G (a regulation-making power to declare that agreements are, or are not, consumer credit contracts)
Consumers are protected from irresponsible lending	0	+ Extends protections of CCCFA to wider range of credit agreements	+ Extends protections of CCCFA to wider range of credit agreements	+ Reduces number of irresponsible lenders by introducing low bar to entry	++ Reduces number of irresponsible lenders by introducing moderate bar to entry	++ Ban will prevent irresponsible mobile traders from operating in market	+ May deter some mobile traders from initiating sales with at-risk consumers	0 No immediate benefits, but may help to address future risks
Lenders comply with existing obligations	0	0	0	+ Higher barrier to entry should improve compliance	+ Higher barrier to entry should improve compliance	+ Bans mobile traders, who have a high rate of non-compliance	0	0
Consumers can access finance to alleviate genuine short-term financial difficulties	0	- May undermine some existing business models and reduce consumers' access to finance	0	- Could result in the exit of some lenders, reducing access to finance	- Could result in the exit of some lenders, reducing access to finance	- Eliminates entire business model, although substitutes likely available	0 Any reduction in access would only be a result of an explicit decision by consumers	0
Legal obligations are clear	0	- May inadvertently capture a wide range of business models	-- Meaning of 'fair market value' could be very uncertain	- May be lack of clarity regarding fit and proper person test	- May be some lack of clarity as to licensing requirements	0	+ Clarifies that 'Do Not Knock' notices have legal effect.	+ Likely to be used to clarify the status of particular contracts
Compliance costs are reasonable	0	- Extends costs of compliance with CCCFA to a number of additional business models	-- Could be very high compliance costs in determining what is 'fair market value'	- Moderate one-off costs	-- Substantial initial and ongoing costs	- Significant one- off 'shut down' costs for banned business models	0	0 No immediate change to compliance costs, but contracts may become regulated in future
Overall assessment	0	0 Unclear if benefits exceed costs	-- Costs highly likely to exceed benefits	+ Improvement on status quo	- Worse than status quo	- Costs likely to exceed benefits	+ Minor improvement on status quo	+ Minor improvement on status quo

Section D5: Conclusions: Continued predatory behaviour by mobile traders

D5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

We recommend the following options:

- Scope Option C: Fit and proper person test in registration of mobile traders
- Scope Option F: Strengthen ability of consumers to require mobile traders to leave their premises
- Scope Option G: Provide a regulation-making power that would enable regulations to define which agreements are, or are not, consumer credit contracts.

Scope Option C: Fit and proper person test in registration of mobile traders

This option would share the main costs and benefits of Registration Option B, which are not reproduced here. The main difference is that it would capture all mobile traders, including those who are not creditors under the CCCFA. As such, it would raise the bar for entry and operation of mobile traders and prevent undesirable and irresponsible individuals from operating, even if they are not creditors under the CCCFA.

This option would impose additional direct costs on those mobile traders who are not already required to register on the FSPR, or undergo fit and proper person assessments. These costs include a registration fee, cost of applying for fit and proper person assessment, the annual levy, and the cost of belonging to a dispute resolution scheme. Some of these costs may be passed on to consumers, via higher prices, interest rates or fees.

This option also imposes additional costs on the Commerce Commission (in assessing additional applications for fit and proper tests) and the Companies Office (which maintains the FSPR). These would be recovered via fees. The Commerce Commission's enforcement functions would benefit significantly from the additional information regarding which businesses are operating as mobile traders.

In addition to the risks outlined in respect of Registration Option B, the main risk of this option is that it will rely on developing an appropriate definition of mobile trader that does not over-capture (such as by including ice cream trucks within its scope) or under-capture (by not including all mobile traders which rely on deferred payment). However, we think that this risk can be alleviated through careful legislative drafting.

This option will place additional registration requirements on mobile traders as compared to other forms of uninvited direct sales. Again, we consider that this is appropriate, because:

- there is greater evidence of harm arising from mobile truck shops than other uninvited direct sales; and
- not all mobile traders – such as those who do not enter a consumer's property – are subject to the Fair Trading Act's provisions relating to uninvited direct sales.

There is also a risk that some mobile traders who do not meet the new requirements may operate unregistered. Others may move their business models online or to direct marketing over the phone, to avoid the requirements.

Finally, while this option should raise the overall standards of practices in the industry, it will not require mobile traders who are not currently creditors under the CCCFA to comply with the CCCFA. As such, there is a risk that the protections provided against mobile traders' practices may still not be sufficient.

Stakeholder views

We did not consult on this option.

Scope Option F: Strengthen ability of consumers to require mobile traders to leave their premises

The Trespass Act 1980 already provides that people may give oral or written trespass notices, with the effect of requiring that the recipients of the notice to stay off the property. However, there is some uncertainty as to whether a 'Do Not Knock' sticker targeted at uninvited direct sales (including mobile traders) would be sufficiently clear about who was targeted by the sticker to qualify as a trespass notice under the Act. The main benefit of the proposed option would therefore be to clarify that such stickers do have legal effect. This would expand the deterrent effect that 'Do Not Knock' stickers and other notices would have on mobile traders.

By amending the Fair Trading Act, the option would extend to all uninvited direct sales, not just those by mobile traders. This recognises that consumers may be vulnerable to sales other than those by truck shops (although we do not have good evidence about this). The change would only apply to goods and services that qualify as uninvited direct sales provided by parties 'in trade' (as opposed to, for example, door knocking by charities or political parties).

The main limitation of this option is that it would not apply in situations outside of the consumer's premises, such as if consumers visit a truck shop parked outside their house, or if the salesperson does not enter the consumer's property. It is possible that mobile traders could exploit this limitation by, for example, playing music to announce their presence and encourage consumers to leave their property. However, we think that a distinction can be made between an active decision made by a consumer to leave their property and visit a truck shop, versus the passive decision made when a trader visits their premises. There is arguably a stronger case for legislative protections in the latter situation.

This option could also overreach, in that it could also result in consumers who use broadly worded notices (such as Do Not Knock stickers) missing out on offers from sellers that they may benefit from (such as electricity switching offers). Given that the law change would only apply if a consumer gave verbal or written notice to the salesperson to leave their property, we think this risk is acceptable. The risk of consumers missing out on sales that they may be interested in could also be mitigated by utilising narrow wording in any stickers that are distributed.

If mobile traders or other direct sellers do not comply with the law, then consumers' recourse at that point in time will be limited. However, the prospect of fines for a breach of the law should nevertheless act as a deterrent, and consumers will still have the ability to call the police (under the Trespass Act) if the salesperson will not leave their property.

There may be some additional cost associated with producing and distributing Do Not Knock stickers and supporting information, however we expect these to be relatively small.

Stakeholder views

We did not consult on this option. However, as noted above, stakeholders were generally in favour of tighter regulation of truck shops. In addition, Consumer New Zealand has been calling for changes to the Fair Trading Act in line with our proposed option for a number of years.

Scope Option G: Provide a regulation-making power to enable regulations that define which agreements are, or are not, consumer credit contracts

This option would enable credit regulation to respond more flexibly to address issues with rapid innovation in the credit markets or deliberate avoidance of the CCCFA, which primary legislation is ill-suited to keep pace with. It would complement the existing exemption powers in the CCCFA.

It would allow for a much more careful and in-depth assessment of the harms from particular unregulated products, and the costs of regulating them, than can be provided in a review of primary legislation such as this, and we consider this is a better response than trying to adjust the scope of the CCCFA in a general way now (as proposed in Scope Option A and Scope Option B, which we do not recommend).

There are no immediate plans to use such a power to 'call in' particular unregulated products to be regulated under the CCCFA, but this ability could address future consumer harm. As well as some credit products offered by mobile traders, a number of new products have been introduced into the credit markets in recent years that have features of consumer credit contracts but fall outside the strict definition in the CCCFA. These include interest-free 'buy now pay later' products such as Afterpay, PartPay, Laybuy and Oxipay. Consumer advocates and some lenders have raised concerns about these products, although there is very limited evidence of harm from them to date. We have not considered bringing them within scope of the CCCFA at this time, however this could be reconsidered if variants of these products emerged that were shown to cause consumer harm.

These powers could also be used to clarify the treatment of particular types of credit contracts, where there is regulatory uncertainty, which is likely to be a significant benefit. For example, there has been recent litigation about the regulatory treatment of peer-to-peer lending. These powers could be used to clarify that treatment, reducing the costs of litigation and ensuring that the CCCFA is applied appropriately.

The main risk of this option is the possibility that products are inappropriately declared to be credit contracts, resulting in undue compliance costs. The costs and benefits of any specific declarations would need to be carefully considered, and these would be subject to a further impact assessment when making any new regulations

Stakeholder views

We did not consult on this option.

Section E2: Problem definition and objectives: Unreasonable fees

E2.1 What is the policy problem or opportunity?

The CCCFA provides that a credit fee or default fee must not be “unreasonable”. Currently the main (but not only) test for the reasonableness of fees is that they recover costs that are closely relevant to the transactional activity (such as processing a loan application) that they are being charged for. They cannot, for example, cover unrelated costs or contribute to profits. The fees requirements put a limit on the fees that can be charged, which varies from lender to lender depending on how their businesses are structured and operate, as well as the types and levels of the costs they incur.

Some costs are relatively straightforward to classify as closely relevant. For instance, the wages paid to a staff member while processing a loan application can be recovered as part of an establishment fee. Other costs are murkier and more difficult to apportion. It may depend on how much input the manager has into loan processing in the course of the transaction, which may vary greatly from loan to loan. The depreciation or service costs of the computer that the staff member uses to process a loan application is likely to be partially recoverable; but the staff member may work on a range of tasks using the same computer, some related to processing the loan application, and others unrelated.

As with problem 2 (non-compliance), the counterfactual is problematic because there is:

- a lack of incentives for lenders to comply with existing legislation; and
- a lack of clarity about principles-based legislation.

Lack of clarity about principles-based legislation

There is a lack of clarity about when a fee is unreasonable. The Supreme Court’s judgement in Sportzone/MTF has clarified the fee provisions to some extent. However, the court noted that the test of “reasonableness” is imprecise, difficult to apply, and that often a creditor will need to set its fees in circumstances where it may not have precise cost information.

In June 2017, the Responsible Lending Code was updated to reflect the Sportzone/MTF ruling. It contains guidance for lenders on how to establish reasonable fees. The effectiveness of this change is not yet known, as it was published relatively recently.

The result is that creditors are continuing to charge excessive fees. Some lenders are charging fees for a range of activities which appear to be disproportionate to the cost of the activity and are inconsistent with what reasonable costs would be likely to include. For example, some charge disproportionate costs for mailing out letters or phone calls when they contact a borrower who has missed a payment. Unreasonable fees appear to be an issue across a wide range of lenders, not just high-cost lenders.

Although it does not comment on whether fees were reasonable, the Commerce Commission’s lender website review found that the median establishment fee for a loan was $275, with 10% of lenders charging $500 or more.[15]

Lack of incentives for lenders to comply

There are difficulties enforcing the prohibition on unreasonable fees including that:

- the burden falls to the Commerce Commission or the borrower to prove that a fee is unreasonable
- there are insufficient penalties to deter some lenders from charging fees which include a profit

[15] Commerce Commission, *Lender website review report*, June 2018, available at http://www.comcom.govt.nz/the-commission/consumer-reports/lender-website-review-report/

margin

- some lenders are not conducting and documenting thorough cost calculations, which makes it time-consuming and costly to check whether or not a particular fee is reasonable
- the combination of difficulties in proving non-compliance and then penalising it means that, in practice, there are relatively few incentives for lenders to comply with the reasonable fees requirements.

The Commerce Commission's submission emphasised the scale of these issues.[16]

Another driver of non-compliance in this field is that consumers do not adequately factor in fees when considering the total cost of credit. One submission noted that there is little evidence that consumers make purchasing decisions based on fees.[17] This threatens the consumer and commercial system aims around ensuring that markets are well-regulated.

As with irresponsible lending, we have little information about types of lenders where there are significant problems with unreasonable fees, as well as the types of lenders where there are few such issues.

Section E3: Options identification: Unreasonable fees

E3.1 What options are available to address the problem?

Fees Option A: Require lenders to substantiate reasonableness of fees

This option would continue the current legislative direction by requiring lenders to have and be able to substantiate reasonable grounds when setting fees, that the fee is not unreasonable. This would require them to calculate fees by reference to the costs of the activities that are being recovered, and to keep records that show how their fees have been calculated. The Commerce Commission could then use its existing information-gathering powers to obtain these records. By comparison, the current legislation does not expressly compel lenders to undertake cost accounting exercises or retain records to support this process.[18]

This would maintain the status quo around setting fees (i.e. Sportzone/MTF). Many lenders also already maintain records of how they set their prices. Therefore for many, this option would not involve major change. The primary change would be around the enforceability of the accounting *process* used.

Guidance already exists in the Responsible Lending Code about appropriate ways to determine 'reasonable' fee levels. Lenders following and documenting this process would have sufficient proof of the reasonableness of their fees. However, the Commerce Commission notes that it is currently extremely resource-intensive and difficult for them to undertake analysis of lender fees, as analysis is done in varying ways and to varying levels of adherence to the guidelines.

If a loan could not be substantiated, the enforcing agency could assume that the correct analysis had not been undertaken and that the fees were therefore not reasonable. It would be a reasonable to assume a breach of responsible lending requirements in that circumstance.

Requests for substantiation would be subject to the Commerce Commission's current information-gathering powers.

Unlike the substantiation option for affordability, this option would only allow the Commerce

[16] 074 – Commerce Commission

[17] 032 – Insurance and Financial Services Ombudsman

[18] 074 – Commerce Commission

Commission to request substantiated evidence of the reasonableness of fees (where borrowers can request substantiation for Enforcement option C).

Fees Option B: Impose specific fee caps in regulation

Fees would still have to be 'reasonable' in line with the Sportzone/MTF case requirements, but could not exceed a specified limit. All fees charged would be included in the cap.

There are a number of potential designs for how fee caps could be set up. These could be set in regulations. Fee caps could be split into caps for each different type of fee – e.g. a cap on establishment fees, a cap on account maintenance, and a cap on default fees. As noted by submitters, they could be based on industry averages for reasonable costs incurred in providing lending services.

There would be a cap on the total fees that can be charged, as a proportion of the loan.[19] Regardless of the specific design of the cap, the cap itself would act as a bright line test. The enforcement agency would be empowered to deem that any fees that exceed the cap were not reasonable, and an infringement fine could be imposed.

Fees Option C: Disclosure and advertising based on an annual percentage rate that combines interest and fees

Lenders do not generally use a 'total amount payable' in advertising, meaning that most consumers cannot compare different loans on equal terms. Under this option, interest rates and fees would be bundled into an 'equivalent interest rate' for disclosure and advertising purposes. This would be similar to the 'annual finance rate' used prior to the CCCFA coming into force in 2004, and the annual percentage rate (APR) used in other jurisdictions such as the United States and the United Kingdom.

Regulation of mandatory fees (i.e. the 'reasonableness' requirement in the existing law and Fees Option B – fee caps) would be removed. There would also be infringement fines for breaching such advertising requirements.

Options in relation to each other

There would be questions around how and whether optional fees would be included in the annual percentage rate recommended in Fees Option C.

Fees Option C (an annual finance rate) and Fees Option B (fee caps) are mutually exclusive, because Option C relies on removing regulation around fees and enabling consumers to make more informed decisions.

E3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to unreasonable fees:

- consumers are protected from irresponsible lending;
- lenders comply with existing obligations;
- legal obligations are clear;
- compliance costs are reasonable; and
- enables consumers to make more informed decisions

The criteria were weighted. The central issues that these options are trying to address are a lack of clarity around legal obligations and a lack of incentives to comply with the law. Therefore, the criteria

[19] 040 – Waahi Whaanui Trust

that were considered most important were “legal obligations are clear” and “lenders comply with existing obligations”. Given the nature of the CCCFA, moderate weight was placed on “consumers are protected from irresponsible lending”. The least weight was placed on the remaining values.

E3.3 What other options have been ruled out of scope, or not considered, and why?

Alternative design for Fees Option A

We considered whether there should be a requirement that substantiation documents be proactively provided to the enforcement agency. This would increase the deterrent effect around non-compliance, increase barriers to entry for lenders that do not intend to act in line with the law, and make enforcement considerably easier. However, it would incur very high compliance costs from responsible and large lenders (who may have to provide thousands of documents to evidence what they are currently doing to ensure that fees are reasonable), and for enforcement (where a large amount of forensic accounting would be undertaken on documents where there was no pre-existing concern around unreasonable fees). Therefore, we feel that the costs outweigh the benefits for this proactive substantiation model.

Alternative design of Fees Option B

We considered whether this option should be designed as a soft cap. There would be a fee cap, but lenders could charge fees above this. However, any fee levels over that cap would have to be substantiated (and would be automatically investigated by the Commerce Commission). However, we decided not to pursue this option because it did not have some of the key benefits of a hard fee cap. In particular, it was not simpler for consumers to understand, incorporate into decision-making, and self-enforce.

Section E4: Impact analysis: Unreasonable fees

	No action	Fees Option A (require lenders to substantiate reasonableness of fees)	Fees Option B (impose specific fee caps in regulation)	Fees Option C (disclosure and advertising based on an annual percentage rate that combines interest and fees)
Consumers are protected from irresponsible lending	0	+ + If the tool results in greater ease and use of enforcement action	**0** Stricter requirements around reasonable fees, but cross-subsidisation likely	- - Easy to manipulate consumer decision making through this model, and provides incentives to do so
Lenders comply with existing obligations	0	+ + If the tool results in greater ease and use of enforcement action	+ Potential for unintended consequences	**0**
Legal obligations are clear	0	**0** “Reasonableness” requirement remains the same	+ Simpler legal obligations	- A number of fees and credit products will be inconsistently captured
Compliance costs are reasonable	0	-	- - May affect viability of responsible business models	**0**
Enables consumers to make more informed decisions	0	**0**	+	- -
Overall assessment	0	+ +	+	-

Section E5: Conclusions: Unreasonable fees

E5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
We recommend Fees Option A: requiring lenders to substantiate reasonableness of fees This option is expected to result in better protections for consumers by enhancing existing incentives to determine that fees are not unreasonable. It has relatively low costs, as responsible lenders should already be engaging in these processes and documenting evidence of this. Although there is a risk that it will incentivise documentation as opposed to having reasonable fees, it is likely that the same outcome will be achieved. On balance, we consider that the benefits for consumer protection outweigh the low compliance costs for this option. *Stakeholder views* This option is supported in a number of submissions. It was also strongly supported by the Commerce Commission. They appeared to indicate that this option would aid in their enforcement work around unreasonable fees. The Financial Services Federation did not support this option on the basis that it is effectively a requirement under existing case law. The Citizens Advice Bureau noted that “clients frequently come to us…to know whether the level of fees is acceptable, and currently this is very difficult to assess.”

Section F2: Problem definition and objectives: Irresponsible debt collection practices

F2.1 What is the policy problem or opportunity?
The purpose of debt collection is to engage with borrowers and motivate repayment of debts. Some level of additional stress is inevitable for people who are reminded about their debts and asked to address them. However, some debt collectors engage in undesirable/irresponsible behaviour. In particular, there are concerns around: • false and misleading claims • unaffordable repayment schedules • excessive charges • harassment. The problems are described in more depth below. MBIE asked for feedback on issues as well as options; feedback on the size and severity of issues is incorporated into this section. The Citizens Advice Bureau[20] noted that they “generally get just under 2000 enquiries per year which are primarily related to debt collection. There has been a small but steady decline in the number of debt recovery and repossession enquiries over the last five years. Most of this appears to be a decline in repossession enquiries following the last reforms to the CCCFA, notably a decline in threats of repossession being used in a punitive manner.” However, we know that the number of complaints to the Commerce Commission (in relation to debt collection) has been steadily rising. It is unclear whether the rise in complaints to the Commerce Commission is due to: (a) an increase in the number or use of debt collectors; (b) an increase in

[20] 086 – Citizens Advice Bureau

undesirable debt collector behaviour, or; (c) because consumers are more willing to complain when they experience an issue. The Commerce Commission's submission also noted that complaints arise from debt collection action in relation to other types of contracts (for example utilities or other contracts for service) and not simply collection on credit contracts.

Complaints to the Commerce Commission about debt collection

Year	Complaints under the FTA	Complaints under the CCCFA	Total complaints
2017	99	20	**119**
2016	68	8	**76**
2015	82	10	**92**
2014	59	5	**64**
2013	17	6	**23**
2012	21	5	**26**

We consider that it is likely that debt collection issues are significantly under-reported. Consumer advocates have told us (during the initial stages of the review) that consumers are reluctant to complain about debt collector behaviour for a range of reasons, including shame and fear, or a lack of knowledge of rights and processes surrounding complaints. Vulnerable consumers are generally less likely to speak up, yet more likely to be the subject of debt collection action. In the United States, minority and low-income communities (markers of vulnerability in the United States) have two to three times more debt collection law suits than less vulnerable societies.[21]

As such, the CCCFA is not protecting consumers from harm for the lifetime of loans. This is likely to disproportionately affect vulnerable consumers, who are more likely to default on debt and therefore face debt collection action.

Several submitters believed that these harms are caused by a small minority of irresponsible debt collectors. One debt collection agency[22] said that they believe this is "general business practice for smaller debt collectors that do not share similar views nor provide scale for what the majority of the industry is actually doing and how the majority of the industry actually operates". However, some consumer advocates disagreed; one submission[23] went as far as saying that the discussion paper's analysis "understates the severity of the issue".

False and misleading claims

The majority of Fair Trading Act-related debt collection complaints received by the Commerce Commission pertain to misrepresentation of rights. The most common types of misleading and false claims being made by debt collectors are: misrepresentations about their right to collect debt (including non-existent debts, debts owed to a different person, or statute-barred debt); and misrepresentations regarding the amount of the debt.

False and misleading claims are prohibited under the Fair Trading Act. Nonetheless, the Commerce Commission's submission notes that "there is some evidence that debtors are not provided with information about the debt including where and when the debt arose…this may contribute to debt collectors making the type of false and misleading claims identified in the discussion paper." However, they also note that much of this occurs in relation to non-consumer credit debt. The Commission notes that this impacts on the debtor's ability to dispute the debt.

Unaffordable repayment schedules

We've heard that many debt collectors send initial letters to borrowers that demand immediate full and final payment of the debt. "Some companies have a hardship team, but in order to get under

[21] Stifler, L. (2017). Debt in the Courts: *The Scourge of Abusive Debt Collection Litigation and Potential Policy Solutions.* Harvard Law & Policy Review (11: 2017). p.110

[22] 014 – Credit Recoveries Limited

[23] 040 – Waahi Whaanui Trust

hardship (interest freeze, lower repayments) the lender ensures the borrower can afford it. If the borrower can't afford it, they are stuck with the original terms of the contract even though the lender has proven the borrower can't even afford the hardship terms!"[24] "Most plans the debt collectors offer (i.e. the only plan they will accept) are oppressive for the borrower".[25]

In some cases, wage deductions are used to obtain repayments, and we have been told that this practice may be increasing. This is problematic for people in hardship because it means that borrowers' incomes go towards debt repayments before essential items like food and bills. When they have limited income, this can also increase the probability of defaulting on a bill, thereby perpetuating debt spirals.

In the related field of repossession, one submission[26] gave an example of a finance company that "had contractual payment arrangements for $65/week that the client couldn't any longer afford and they'd fallen into arrears. [The lender] threatened to repossess the client's property unless the client agreed to $95/week repayments to help clear arrears. This was an unreasonable expectation given that the client couldn't even afford the original $65. The client felt pressed to accept these terms. When [the submitter] spoke to [the lender], their own affordability assessment had her falling short by $40 to the new verbal arrangement".

Excessive charges

Incurring additional costs is a reasonable consequence of not repaying a loan in the time agreed, and is a good way of motivating prompt payment. However, extremely high costs may be seen as disproportionate and punitive. Such costs can create debt spirals, trapping individuals into many years of repayments, and perpetuating hardship.

The Citizens Advice Bureau[27] noted that the most common debt collection enquiry they receive is related to cost.

Examples we've heard of include a $30 letter fee incurred when the debt is initially passed on to the debt collector, $15 being charged per phone call, a monthly "arrangement fee" of $5 for the term of the repayments, and a $1 transaction fee per payment.[28] One submitter[29] gave several examples, including:

- collection costs of $8,762 on debt of $29,335 (30% additional collection costs); and
- collection costs of $11,796 on debt of $46,161 (26% additional collection costs).

The examples from this submitter (who undertook some market research) commonly shows contingency collection fees of between 15% and 45% being charged.[30] According to a debt collection agency, 20% is the general benchmark charge in the debt collection industry.[31] The example given in the submission is that a $2000 overdue account will have $400 added in debt collection fees. The submission[32] further states that "when clients outsource their accounts to a third-party debt collection agency, it is the general practice that any interest component ceases being charged since the customer attracts this collection cost. While there is an ability to charge this interest, albeit an

[24] 005 – Charlotte Whitaker

[25] 005 – Charlotte Whitaker

[26] 076 – Christians Against Poverty

[27] 086 – Citizens Advice Bureau

[28] Anonymised examples provided by a consumer advocate

[29] 076 – Commerce Commission

[30] 076 – Commerce Commission

[31] 014 – Credit Recoveries Limited

[32] 014 – Credit Recoveries Limited

annual interest or default interest, general industry practice suggests that this is not done."

In some cases, total collection costs are bigger than the initial loan. One submission noted that "it is possible that reasonable debt collection costs might exceed the initial loan, where the loan is very small".[33]

Harassment

Stakeholders have raised concerns about unlawful harassment being used by some debt collectors as part of normal business practice. The Commerce Commission's 2016 consumer issues report noted that there are growing numbers of complaints in this area. One submitter[34] noted that "there are clear rules about debt collection and these are frequently ignored as few people know about them or are intimidated by collection agents".

Consumer advocates gave a number of examples of harassment:

- One consumer advocate[35] gave an example of a lender manager who "threatened to visit our client's work place…they have harassed the client and convinced them that they should not work with [the advocate, a budgeting service] to a point where our relationship with the client was placed in jeopardy…this resultant behaviour caused none of their creditors to be paid, and consequently placed [the lender] as a preferential creditor by pure default and bad faith".
- Another consumer advocate[36] described a client who was being visited by a debt collection agency (in his home and the home of his wife's parents) every other day. "The threats being made were intimidating and misleading – threats to repossess all their household goods, to get the client fired from his job, to take possession of his parent's property." When the advocate got involved and asked for information about the debt, they claim that the debt collector refused to provide any documented evidence of the existence of the debt.
- The same advocate[37] gave another example of a financial mentor that was sent "six text messages and two phone calls per day, every day, including weekends" when they attempted to negotiate an affordable repayment plan for their client.
- The same advocate[38] described a case where a debt collector falsely reported a client to the police (for supposedly stealing a security) when the client entered a No Asset Procedure.

At the extreme end of claims of harassment, one consumer advocate[39] claimed that they know of "some creditors who use gang members to enforce debt collection, which is extremely intimidating for clients."

On the other hand, some lenders and debt collectors emphasized that they had clear contact policies that they did not consider to constitute harassment. One submission stated "we do not call consumers once they have a repayment arrangement with [the lender]. Additionally, we call consumers between 8am and 6pm and not outside those hours. We do not speak with employers as this would likely be a breach of the Privacy Act". [40]

Strength of evidence

We have little quantitative information in this area. We do not have industry-wide data on how many

[33] 051 - Westpac

[34] 052 – Debt Blocker

[35] 076 – Christians Against Poverty

[36] 040 – Waahi Whaanui Trust

[37] 040 – Waahi Whaanui Trust

[38] 040 – Waahi Whaanui Trust

[39] 040 – Waahi Whaanui Trust

[40] 051 - Westpac

consumers are pursued by debt collectors, or the size of the debt collection market.

We also do not know how many consumers are affected by adverse debt collector behaviour, or the frequency of this behaviour. Submitters had different perspectives on the extent of debt collection issues. For example, a number of consumer advocates[41] felt that this was a very significant issue in the credit industry, whereas debt collectors[42] noted that the number of Commerce Commission complaints is a very small percentage of their total industry size.

We note that stakeholders have been raising this as an area of concern for a number of years, and that numerous submitters confirmed there are harmful practices taking place. This suggests that genuine issues do exist, and are not localised to one particular area or collection agency.

Section F3: Options identification: Irresponsible debt collection practices

F3.1 What options are available to address the problem?

Debt Collection Option A: Increase disclosure requirements at the commencement of debt collection

This option would involve requiring all debt collectors to disclose particular information at the commencement of debt collection action. The exact information to be disclosed should be established in regulations, so that industry can be consulted on the details.

All debt recovery would cease until disclosure is made.

Debt Collection Option B: require debt collectors to offer an affordable repayment plan

This option would involve establishing:

- A new legislative requirement that a debt collector, in any communication with a borrower in default (as far as practicable), offer the borrower a new affordability assessment. If the borrower accepted the offer, either a new affordable repayment schedule would need to be determined or debt collection action would need to cease (other than official enforcement action such as repossession and court proceedings).
- A legislative requirement that no further interest or fees could be charged once the borrower had agreed to an affordable repayment schedule. There could be timeframes in which these steps should occur.[43]
- Guidelines in the Responsible Lending Code about how affordability assessments should take place.

Debt Collection Option C: Limit contact between the debt collector, borrower and other persons

This option would involve establishing:

- A legislative requirement that debt collectors only make appropriate and reasonable contact

[41] 040 – Waahi Whaanui Trust

[42] 067 - Baycorp

[43] 032 – Insurance and Financial Services Ombudsman

with debtors and other persons.

- A regulation-making power to establish the frequency and types of contact that were considered appropriate and reasonable.
- A legislative requirement that a borrower would have the right to nominate a representative who the debt collector must contact instead. All further contact with the borrower would then be prohibited, apart from a confirmation that contact will cease, and notices of official enforcement action such as repossession or court proceedings. The borrower would have the right to cancel the request at any time. The debt collector could contact the borrower in respect of a new debt (subject to the same borrower right to cease contact).
- Further guidance in the Responsible Lending Code (or similar) on how to fulfil these obligations.

The debt collector could also contact other persons, but only for the purpose of finding out the borrower's contact details. The debt collector would be prohibited from discussing the debt with any other person (consistent with existing rights under the Privacy Act 1993).

Debt Collection Option D: Make third-party debt collection agencies directly subject to the CCCFA

The discussion paper sought feedback on the potential to expand the scope of application of the CCCFA in a number of ways. These included debt collection option D: make third party debt collectors directly subject to the CCCFA. This type of debt collector is currently only liable under the CCCFA via their agency relationships with lenders. This means that if or when third party debt collectors breach the CCCFA, the lender is liable for the breach (not the debt collector). This option would make third party debt collectors directly liable under the CCCFA.

Debt Collection Option E: Make external debt collection fees cost-based

Under this option, only the actual costs incurred by debt collectors acting as agents of creditors could be passed on to borrowers. Section 44A of the CCCFA would be amended to clarify that debt collection fees count as default fees, and so would be required to not be unreasonable. Any additional fees or commissions charged by the debt collector would need to be paid by the creditor.

F3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the options relating to irresponsible debt collection:

- consumers are protected from irresponsible debt collection;
- reduces irresponsible debt collection behaviours;
- legal obligations are clear; and
- compliance costs are reasonable.

The first two criteria ("consumers are protected from irresponsible debt collection" and "reduces irresponsible debt collection behaviours") were weighted more heavily than the other criteria, as they reflect the issues that these problems attempt to address.

F3.3 What other options have been ruled out of scope, or not considered, and why?

N/A

Section F4: Impact analysis: Irresponsible debt collection practices

	No action	**Debt collection option A** (increase disclosure requirements at the commencement of debt collection)	**Debt collection option B** (require debt collectors to offer an affordable repayment plan)	**Debt collection option C** (limit contact between the debt collector, borrower and other persons)	**Debt collection option E** (make external debt collection fees cost-based)
Consumers are protected from irresponsible debt collection	**0**	+ Increased ease of redress	+ Risks of unintended consequences	+ Risks of unintended consequences	**0** Risks of unintended consequences
Reduces irresponsible debt collection behaviours	**0**	+	**0** Risks of unintended consequences	+ Risks of unintended consequences	**0** Risks of unintended consequences
Legal obligations are clear	**0**	++	+	+	+
Compliance costs are reasonable	**0**	- Raises costs, but some debt collectors already doing some disclosure	-	**0**	-
Overall assessment	**0**	++	+	+	**0**

Section F5: Conclusions: Irresponsible debt collection practices

F5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

The only option that we recommend proceeding with is Debt Collection Option A: increase disclosure requirements at the commencement of debt collection.

This option has significant benefits, especially around improved transparency and enhanced self-enforcement opportunities. Accurate information would benefit debtors, who could more readily understand the debt, work with debt collectors to establish a repayment plan, and challenge the debt if necessary. It would also benefit debt collectors, who could resolve the debt more readily if all parties understood key facts of the loan.

It has comparatively few costs, given that debt collectors indicated in their submissions that they already undertake a level of disclosure. Compliance costs will be higher for all debt collectors, and there is a small risk that some debt collectors will use fraudulent documents.

On balance, we consider that the benefits to consumers outweigh the costs to lenders.

Stakeholder views

There was broad support for this option, including from some disputes resolution schemes, a lender, a debt collector, and a consumer advocate. The Financial Services Federation (and several other submissions from debt collectors) noted that 'responsible' debt collectors already provide most of the information specified in this option "as standard practice at the commencement of debt collection action".

Other options not recommended

Debt Collection Option B: Require debt collectors to offer an affordable repayment plan

The intention of this option was to provide stronger protection for debtors, limiting consumer harm resulting from both unaffordable repayment schedules, and excessive charges. However, there are a number of costs and risks associated with this option. These include that it would be more difficult for debt collectors to recover their costs and recovery rates may reduce. It may also create incentives for creditors to take alternative enforcement action, such as repossession or court proceedings in preference to debt collection. This may result in greater consumer harm than the status quo. Other risks include increasing contact between debtors and debt collectors (which may or may not be desirable).

A major limitation of this assessment is that we have received insufficient information to accurately assess the extent and probability of the costs and benefits. Further work is required to understand the potential consequences of legislative change in this area.

Debt collection Option C: Limit contact between the debt collector, borrower and other persons

This option would help to protect the most vulnerable consumers, who are most likely to face debt collection action. More prescriptive requirements would also be easier for the Commerce Commission to enforce, and for debtors to understand their rights.

A major cost is that the new processes are likely to reduce recovery rates. This may result in higher risk being associated with some types of credit, and the cost of credit being raised. Alternatively, debt collectors may mitigate this by taking debts to court earlier. This may also have negative effects for debtors.

As with debt collection option B (affordable repayment plans), a major limitation of this assessment is that we have received insufficient information to accurately assess the extent and probability of the costs and benefits. Further work is required to understand the potential consequences of legislative change in this area.

Debt Collection Option D: Make third-party debt collection agencies directly subject to the CCCFA

This option would not effectively address consumer harm in relation to debt collection. Submitters also noted that it wouldn't address concerns about debt collection that wasn't in relation to consumer credit.

Debt Collection Option E: Make external debt collection fees cost-based

The main benefits to this option are that it would increase ease of enforcement, and that it may increase competitive and market forces to drive down prices. However, this may not result in lower costs of debt collection for consumers.

5.2 Summary table of costs and benefits of all the preferred options

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Regulated parties	We expect a modest increase in the cost of regulated parties due the reforms proposed. Most of the reforms are clarifications of existing requirements.	Low	Low
Regulators	The primary regulator will see an increase in cost. This will include an increase in enforcement and administration of the fit and proper person test.	Medium	Low
Wider government	We don't foresee increased costs to wider government.	Low	Low
Other parties	We don't foresee increased costs to other parties.	Low	Low
Total Monetised Cost	*Not known* Without solid quantifiable evidence it is difficult to be precise	*Not known*	*Not known*
Non-monetised costs		Low-Medium	Low
Expected benefits of proposed approach, compared to taking no action			
Regulated parties	Some benefits will ensue from	Low	Low

	increased legal certainty		
Regulators	The Commerce Commission will see increased benefits from legal certainty and easier enforcement options.	Medium	Low
Wider government	There is a possibility of reduced access of social welfare support to deal with problem lending but this is difficult to assess.	Low	Low
Consumers	We expect a modest increase in the benefits to consumer due to the reforms proposed.	Medium	Low
Total Monetised Benefit	*Not known* Without solid quantifiable evidence it is difficult to be precise	*Not known*	*Not known*
Non-monetised benefits		Medium	Low

5F.3 What other impacts is this approach likely to have?
Some options may make credit less accessible to some groups of consumers. This could have indirect impacts if consumers who cannot access credit easily must go without certain necessities or look for finance options elsewhere, including illegal sources.

5F.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?
Yes

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
The proposed approach will be given effect by a CCCFA Amendment Bill. Responsibility options A, C and D will be given effect in regulations, subject to the creation of new regulation-making powers in the CCCFA via the Amendment Bill. The detailed content of any new regulations will be consulted on with affected parties to ensure they are workable. These new regulations may result in updates to the Responsible Lending Code as necessary. Once implemented, the Commerce Commission will continue to be responsible for ongoing enforcement of the new amendments. The amendments will have a one-year transitional period from royal assent to commencement. We consider that a one-year transitional period will be enough for regulated parties to make necessary changes to their practices.

6.2 What are the implementation risks?
The main implementation risk is the Commerce Commission not being adequately resourced to handle an increase in responsibility. The Commission considers extra funding will be required for the effective implementation and enforcement of proposed additional regulation. MBIE estimates the Commission will require an additional $3 million annually for operational expenditure. We will work with the Commission and The Treasury to ensure the necessary funding arrangements are

made.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

To assess whether the anticipated impacts materialise, we will need to monitor the consumer credit industry. Further information on evaluating and reviewing these changes is included below in 7.2.

As the enforcement agency for the CCCFA, the Commerce Commission produces an annual consumer issues report which identifies current issues and emerging risks that have the potential to affect consumers or markets. As part of these reports, the Commerce Commission uses its own data as well as information from other government and community agencies to present a picture of the consumer credit environment, including the number of complaints, enforcement responses and prosecutions for breaches. Consequently, the consumer issues reports are an effective tool for monitoring changes in the consumer credit industry over time.

We would also rely on Commerce Commission reviews, investigations, cases etc. on an ongoing basis. This information, as well as data on the costs of implementing and enforcing the changes from the Commission, would be exchanged with MBIE.

We will have ongoing engagement with lender, consumer and government stakeholders through regular catch-ups, and formal engagement through forums such as MBIE's Consumer Protection Partnership Forum (comprised of consumer advocates and government agencies) and the Responsible Lending Code Advisory Group (comprised of lenders, dispute resolution schemes, and consumer advocates). These forums will provide the opportunity for us to monitor on the ground impacts on lenders and consumers and identify any issues with the new arrangements.

7.2 When and how will the new arrangements be reviewed?

While there are currently no plans for a formal review of these changes, MBIE regularly evaluates and reviews amendments to the law it administers. The changes could, for example, be reviewed and evaluated two to three years after coming into force (subject to resource constraints). An evaluation or review at this time would allow the changes to have bedded in and any anticipated and desired impacts to show.

Research and data collection is planned to be carried out while the Amendment Bill passes through the different stages of the House. The aim of this research would be to produce a baseline of evidence and data measuring the makeup and structure of the consumer credit markets prior to the introduction of the law changes. The baseline could include research and primary data collection around consumer awareness of the law, borrowing behaviours and trends, lender practices, compliance with the responsible lending principles and the size of the industry.

Having a stocktake of the consumer credit markets before the changes come into force will enable effective monitoring and evaluation of the law changes when they are reviewed. A similar baseline evaluation and data collection was carried out by MBIE in 2016 and is available at http://www.mbie.govt.nz/publications-research/research/consumer-protection/compiled-CCCFA-baseline-evaluation-report.

The monitoring identified above in 7.1 is likely to capture any unexpected results or impacts which may arise as a result of the changes. Any issues or concerns that stakeholders have in relation to implementation of the changes can be directed to the relevant enforcement body, the Commerce Commission.