MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Dr David Clark	**Portfolio**	Commerce and Consumer Affairs
Title of briefing	Preventing financial hardship caused by the use of Buy-Now, Pay-Later	**Date to be published**	10 November 2022

List of documents that have been proactively released		
Date	**Title**	**Author**
October 2022	Preventing financial hardship caused by the use of Buy-Now, Pay-Later	Office of the Minister of Commerce and Consumer Affairs
27 October 2022	Preventing Financial Hardship Caused by the use of Buy-Now, Pay-Later GOV-22-MIN-0038	Cabinet Office
20 October 2022	Regulatory Impact Statement: Applying the Credit Contracts and Consumer Finance Act in a proportionate way to Buy-Now, Pay-Later arrangements	MBIE

Information redacted **YES** / **NO**

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reason of Confidentiality.

Regulatory Impact Statement: Applying the Credit Contracts and Consumer Finance Act in a proportionate way to Buy-Now, Pay-Later arrangements

Coversheet

Purpose of Document	
Decision sought:	*Amendments to the the Credit Contracts and Consumer Finance Act to cover Buy-Now, Pay-Later arrangements*
Advising agencies:	Ministry of Business, Innovation and Employment
Proposing Ministers:	Minister of Commerce and Consumer Affairs
Date finalised:	19/10/2022

Problem Definition
Buy-Now, Pay-Later is causing or worsening financial hardship for some consumers.

Executive Summary

Buy-Now, Pay-Later (BNPL) is a relatively new form of short-term, unsecured credit which allow consumers to pay for goods and services from a wide range of merchants through a third-party provider (a BNPL lender) with no interest. Because BNPL lenders do not charge the consumer interest or fees (except late payment fees), they are not a 'consumer credit contract' under the Credit Contracts and Consumer Finance Act 2003 (CCCFA), and BNPL users are not subject to the CCCFA's protections.

BNPL arrangements can provide a convenient low-cost alternative to traditional consumer credit products. There are also wider benefits of BNPL arrangements, particularly from the competition created by innovation in the provision of credit, and the emergence of new entrants into financial services. However, although BNPL does not charge interest to consumers, there is evidence that BNPL can cause or worsen financial hardship for some consumers.

In October 2021 a discussion document was published seeking submissions on how BNPL could cause or worsen financial hardship and on options to reduce financial hardship caused by BNPL while maintaining the benefits of BNPL arrangements.

Evidence from overseas, submissions on the discussion document, and a survey conducted by MBIE indicate that the main cause of financial hardship from BNPL stems from consumers using BNPL to purchase goods which they are unable to afford, given their income and other expenses.

This is exacerbated by the ability of a consumer to have multiple BNPL arrangements across different lenders.

A range of possible options have been identified to address financial hardship caused by BNPL lending while allowing the benefits of BNPL to continue. These options are:

- Option One: Status Quo/Counterfactual
- Option Two: Apply the CCCFA BNPL, with full affordability assessments
- Option Three: Apply the CCCFA to BNPL, with no affordability assessments
- Option Four: Apply the CCCFA to BNPL, with light affordability assessments
- Option Five: Apply the CCCFA to BNPL, with full affordability assessments above $200
- Option Six: Apply the CCCFA to BNPL, with light affordability assessments above $600
- Option Seven: Mandatory industry code.

This RIS concludes that Option Six light affordability assessments above $600) is the option that is most likely to achieve our objectives. Our analysis suggests that this option will reduce financial hardship caused or worsened by BNPL arrangements, but at the cost of reducing access to credit, or increasing the cost of credit, for some BNPL users. While there is some risk, we consider that this is the option with the lowest risk of increasing the cost of credit while minimising financial hardship from BNPL arrangements.

Limitations and Constraints on Analysis

The BNPL sector is relatively new and is in a growth phase which makes it difficult to assess how the status quo will develop as the market matures. New types of BNPL and business models are being introduced in New Zealand and overseas. To simplify analysis, we have assumed that the status quo will continue in the absence of further regulatory change though in reality there may be major, unpredictable market developments that substantially change the problem definition and the impacts of regulatory options.

Key evidence of consumer harm comes from an MBIE survey which, while surveying a relatively large number of users, used a non-representative sampling frame (social media promotion), and may be biased as a result. However, the findings are consistent with data provided by financial mentors as well as data from credit bureau Centrix.

To assess the impacts of the options, we have asked BNPL lenders directly about the cost of CCCFA compliance. Some lenders are well placed to advise on this as they also offer CCCFA compliant products. Other lenders were not clear on the obligations or the costs of compliance. Few BNPL lenders were able to provide an estimate on the cost of assessing affordability and we have based our assumptions on the estimate we received which seems most plausible.

One key area of limited information has been the cost to lenders of obtaining a credit report on consumers. Neither lenders nor credit bureaus have provided this information, citing commercial confidentiality. We have assumed that the cost is relatively low, given that some BNPL lenders obtain these reports already, and this has not been cited as a major compliance cost.

Responsible Manager	
Glen Hildreth Manager, Consumer Policy Ministry of Business, Innovation and Employment 19 October 2022	

Quality Assurance	
Reviewing Agency:	Ministry of Business, Innovation and Employment Regulatory Impact Assessment Review Panel
Panel Assessment & Comment:	MBIE's Regulatory Impact Analysis Review Panel has reviewed the Regulatory Impact Statement prepared by MBIE. The panel considers that the information and analysis summarised in the Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

What is Buy-Now, Pay-Later

1. BNPL is a relatively new form of short-term, unsecured, interest-free credit. BNPL allows consumers to pay for goods and services from a wide range of merchants, funded by a third-party BNPL lender. The merchant typically pays the lender a fee, and in exchange receives payment for the good or service at the point of sale. The BNPL lender then collects instalments from the consumer. Typically, at least one instalment is paid at the time of purchase (effectively a deposit).
2. For example, a consumer may wish to purchase an item from a merchant priced at $100. At the point of sale, the consumer pays $25 to the lender and is scheduled to make another 3 payments of $25 at fortnightly intervals thereafter. The merchant receives $100 for the item less any fees (e.g. if fees are set at 5 per cent of the value of the item, the merchant would receive $95, and the lender would receive $5). We understand that some merchants pass these fees on to consumers via a surcharge.
3. If the consumer is late or misses an instalment, the BNPL lender may charge the consumer a fee. Fees range from flat fees (e.g. $10 for a missed instalment) to a percentage of the value of the transaction.
4. Instalments can be paid by credit card, debit card or bank transfer. If credit cards are used, there is the additional risk of the consumer facing additional credit card fees or interest.
5. BNPL lenders often give consumers a predefined credit amount which they can spend up to with that lender (much like a credit limit on a credit card).

Why is BNPL not covered by existing consumer credit laws?

6. As BNPL arrangements do not charge consumers interest or fees (unless an instalment is missed) they are not classified as a consumer credit contract under the CCCFA. BNPL lenders are therefore not required to adhere to the obligations that apply to other forms of consumer credit such as credit cards, personal loans and mortgages. These obligations include responsible lending principles (such as carrying out affordability and suitability assessments), disclosure obligations, and requirements for directors and senior managers to be certified as fit and proper persons.
7. BNPL arrangements are not classified under existing consumer credit regulations in other jurisdictions. The UK for example has announced it will regulate the sector to ensure "people are treated fairly and only offered agreements they can afford".[1] In Australia BNPL lenders have created a voluntary industry code to address concerns about financial hardship whilst balancing the benefits of BNPL. The Australian Government has also announced it intends to regulate BNPL.

Overview of BNPL sector in Aotearoa New Zealand

8. BNPL arrangements are currently offered by six lenders, many of which also have operations overseas. Some are new entrants and solely offer BNPL arrangements such as Afterpay, Zip, Laybuy and Openpay. Others offer (or have partnerships with

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[1] John Glen, Economic Secretary to the Treasury, https://www.gov.uk/government/news/buy-now-pay-later-products-to-be-regulated

those who offer) other credit products notably Genoapay (which is owned by Latitude Finance) and Klarna. Another provider, Humm, recently left the New Zealand market.

9. BNPL has been growing rapidly in recent years, particularly with online purchases - with a large spike in growth during the first COVID-19 lockdown in April/May 2020. Our most recent figures show the amount of money spent with BNPL in New Zealand grew to $1.7 billion in 2021 (up from $755,000,000 in 2020).

Confidentiality

Why is BNPL experiencing such growth?

11. BNPL provides a simple product which charges no interest. It allows consumers to purchase goods and pay them off over a short period of time.

12. It is also possible that the high amount of consumers without savings could be driving the use of BNPL as a way to spread the cost of larger purchases out over time.[2]

BNPL lenders previously attempted to create an industry code

13. Several BNPL lenders in New Zealand have begun developing a voluntary industry code, based on the Australian industry code.

14. A draft of the code was produced in 2021, in response to this the Minister of Commerce and Consumer Affairs publicly stated that he believed the code did not do enough to address financial hardship caused by BNPL.

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[2] https://assets.retirement.govt.nz/public/Uploads/Research-2020/TAAO-RC-NZ-FinCap-Survey-Report.pdf, page 13

15. There appears to have been no further progress on the code and there is currently no BNPL industry body within New Zealand who would be best placed to carry forward development of a code.

The future of BNPL in New Zealand under the status quo

16. BNPL is experiencing significant growth in New Zealand. Recent years have seen new entrants into the market combined with consolidation in the sector, both in New Zealand and overseas.

17. As the BNPL industry is relatively young, all providers in the New Zealand market are currently pursuing a growth model and we understand that none are currently profitable. This makes it difficult to predict what a mature market will look like.

18. A more mature market could see further consolidation between the providers once growth of new customers slows. This may come in the form of lenders using their BNPL products to complement a wider variety of products and services. For example, in Australia the Commonwealth Bank of Australia has announced plans to launch a BNPL product linked to its bank accounts, while Apple is launching a BNPL product in the US to complement its Apple Pay service.

19. Other notable evolutions in BNPL are the use of existing retail payment systems (such as the Visa or Mastercard schemes) to make BNPL purchases on a BNPL lender-issued card. This allows the consumer to use their BNPL account wherever the card (Visa or Mastercard) is accepted. For example, Bundll (created by Humm a BNPL provider) launched a BNPL account linked to MasterCard which can be used at any retailer that accepts MasterCard. While this has since been withdrawn from the New Zealand market, similar offerings are available overseas.

Linkages with other work streams

20. Carrying out an assessment of a borrower's ability to repay a loan before entering into a consumer credit contract is a key protection of the CCCFA. However, it relies on the lender collecting information about the borrower's financial position, which can be difficult for BNPL lenders given the contracts are often entered into at the point of sale. Concerns around the cost and ability to undertake affordability assessments could be addressed through the Consumer Data Right (CDR) once implemented, if applied to the banking sector. In July 2021 Cabinet agreed to introduce a CDR which will allow consumers to share the data held about them with trusted third parties [DEV-21-MIN-0415 refers]. This could allow lenders to access accurate data about borrowers, on the borrower's consent, to improve the efficiency and accuracy of lending decisions. Drafting has begun on a Bill to give effect to these decisions.

21. The Retail Payment System Act 2022 (RPS Act) regulates the retail payments system with a view to promoting competition. The RPS Act, amongst other things, aims to reduce the high cost of interchange fees charged to merchants for accepting certain types of payments, and provides for the passing-on of these fees to consumers to be regulated to prevent excessive surcharging. While BNPL lenders are not currently subject to the RPS Act it is possible that they may be designated in the future should concerns emerge.

What is the policy problem or opportunity?

Overview

22. BNPL provides low-cost credit and competes with higher-cost credit products such as credit cards. However, the BNPL characteristics make it easier for certain consumers to overextend themselves by purchasing goods or services which they cannot afford.

The challenge is to reduce the risk of those consumers overextending themselves, while not increasing the cost or reducing access to credit for the majority of consumers.

Benefits of BNPL

23. BNPL arrangements are a convenient low-cost alternative to traditional consumer credit products. BNPL provides a form of credit for consumers who may otherwise be declined credit and/or be forced to seek a higher interest loan.

24. Providing lower cost credit theoretically should drive other credit providers to innovate to offer newer or cheaper credit products to consumers to better compete with BNPL offerings.

Costs of BNPL in terms of financial hardship

25. Financial hardship is when a consumer is unable to pay for what they need to live. Essentially this occurs when expenses and financial commitments exceed income over a period.

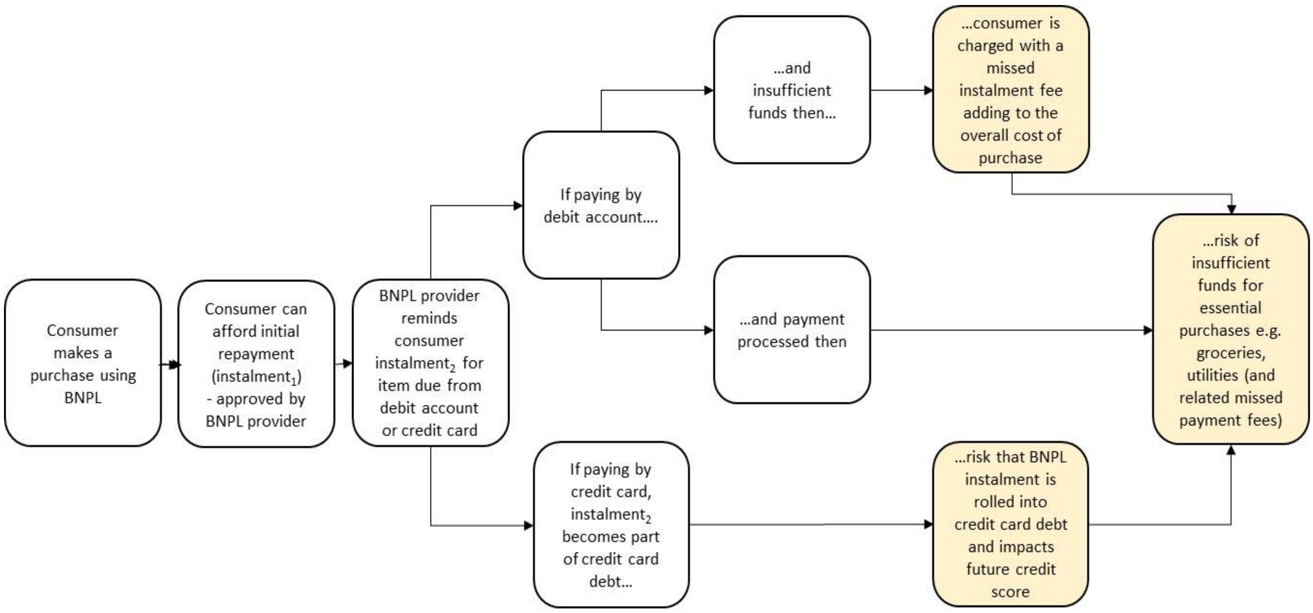
26. BNPL allows people to access credit almost instantly at the point of purchase and breaks up the cost of the purchase into instalments.

27. The instantaneous nature of the credit, the low upfront cost and several other features of BNPL (discussed in more detail below) can hide the true cost of borrowing and result in some users spending more than they can afford. This leads to financial hardship when BNPL payments push a person's expenses higher than what they can afford to pay. BNPL can also worsen existing hardship in this way.

28. Hardship may be exacerbated if the borrower defaults on BNPL payments (resulting in late payment fees being charged), or BNPL instalments cause the borrower to default on other financial commitments that incur additional interest and fees.

29. The majority of financial mentoring services submitted that a lack of affordability at the outset of a BNPL contract was the main cause of financial hardship they saw from BNPL. This is consistent with MBIE's 2021 BNPL consumer survey (the Survey), in which only 24 per cent of survey respondents who delayed or missed bills or essential expenses attributed this to a change to their personal circumstances, such as job or income losses.

Figure 2: Pathway to financial hardship



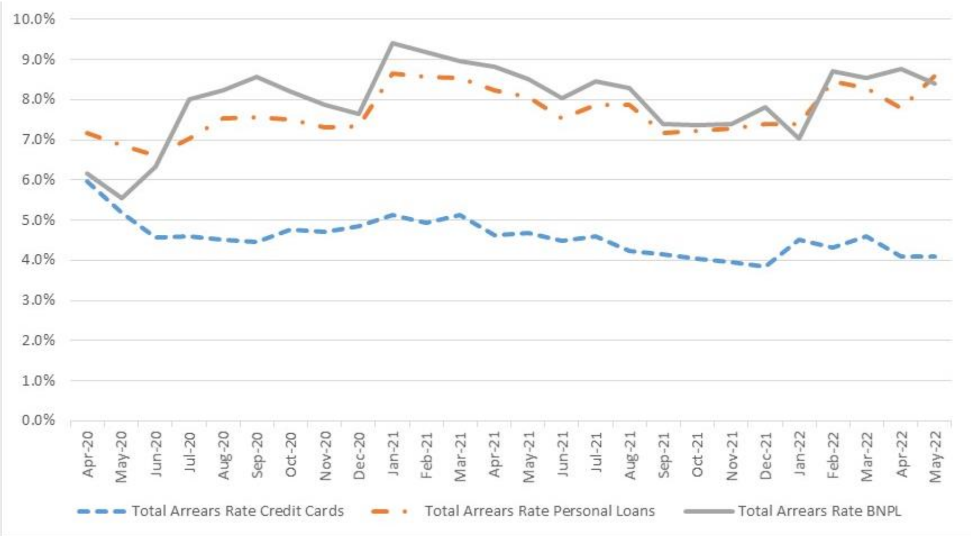
Indicators of financial hardship

30. Credit reporting data provides comprehensive information about payment arrears, which may be indicative of hardship, but does not provide information about borrowers who pay their BNPL debts on time at the cost of missing other essential expenses and financial commitments. Data covering around 35 to 40 per cent of the New Zealand BNPL market,[3] suggests that as at the end of May 2022, 8.4 per cent of active BNPL customers were in arrears (late or missed payments). In comparison, around 8.6 per cent of personal loans and 4.1 per cent of credit cards were in arrears.

31. In the Survey, 13 per cent of current BNPL users said that BNPL has caused them to delay payment of bills or cut back on other essential expenses, or that they have missed three or more repayments. 44 per cent of respondents who no longer used BNPL said it was because they found it hard to stop purchasing more than what they could afford.

32. Financial mentors have reported that BNPL debts are becoming much more common among their clients who are struggling with financial hardship and debt. One provider reported that 2 per cent of clients had BNPL debt in 2019, 6 per cent in 2020 and 17 per cent in 2021.

Figure 3: Total arrears rates by product type



Source: Data commissioned by MBIE from Centrix as part of its Comprehensive Credit Reporting platform, May 2022.

Several features of BNPL contribute to likelihood of financial hardship for some consumers

33. That some consumers enter into BNPL contracts that they cannot afford, and this causes or worsens financial hardship and harms those consumers, reflects underlying limitations of borrower decision-making. Some of these limitations include known drivers of consumer vulnerability, such as various health and physical factors, adverse life events, low financial resilience, or low financial capability.[4]

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[3] Data commissioned by MBIE from Centrix as part of its Comprehensive Credit Reporting platform, May 2022.

[4] Council of Financial Regulators, *Consumer Vulnerability Framework*, https://www.cofr.govt.nz/files/consumer-vulnerability-framework.pdf

34. Certain features of BNPL contribute to consumers ending up in unaffordable BNPL contracts:

- lack of consideration of affordability by BNPL lenders
- speed of transactions
- the ability to have multiple BNPL arrangements across different lenders, with little or no visibility of BNPL accounts to other BNPL lenders or other lenders such as banks and finance companies
- BNPL credit amounts being automatically increased
- late payment fees
- the timing of instalments not coinciding with the timing of income and/or occurring at the same time as other expenses
- use of credit cards to pay instalments
- promotion of BNPL.

Lack of consideration of affordability

35. A notable consequence of BNPL being excluded from the CCCFA is that BNPL lenders are not subject to any obligations to assess whether their products are affordable for consumers, and do not make these assessments.

36. BNPL lenders, like all commercial lenders, have incentives to reduce default. However, BNPL lenders take steps to address default risk other than considering affordability. This includes consideration of the borrower's repayment history and other readily accessible information about the borrower, the merchant, and the proposed transaction. BNPL lenders charge debit cards, credit cards and bank accounts directly to take payments (rather than them being voluntarily made).

37. Some of a BNPL lender's considerations may be correlated with affordability – if a borrower's income does not cover their financial commitments, they are likely to have a poor repayment history. However, likelihood of default also reflects purely behavioural characteristics of the borrower, such as how committed the borrower is to meeting their debt commitments, and whether they are prepared to prioritise these over other expenditures.

38. Beyond a lack of lender consideration of affordability, the likelihood that a borrower takes out a BNPL arrangement that causes them financial hardship is increased by certain features of BNPL.

The ability to have multiple BNPL arrangements across different lenders

39. There are currently six BNPL lenders operating in New Zealand not all of which participate in credit reporting and none of which carry out comprehensive affordability assessments. This means BNPL providers have little visibility of users other BNPL credit arrangements and other credit generally.

40. This can lead to:

- Borrowers struggling to keep track of payments being debited from their accounts. 43 per cent of respondents to the Survey who had delayed or missed bills or essential expenses attributed payment difficulties to having accounts with multiple BNPL lenders and being unable to keep track of payments.
- Borrowers who are in arrears with one BNPL lender obtaining credit from another BNPL lender.

41. Several financial mentors submitted that this was a key concern for them. FinCap provided data that showed 13 per cent of people who were working with a financial mentor and had BNPL debt had three or more concurrent BNPL debts.

42. The BNPL industry submission outlined their proposed approach to multiple BNPL accounts which relies on the Centrix Indebtedness Indicator (Indicator). The Indicator will alert BNPL lenders if a new account applicant has an active overdue account with another BNPL participating provider.

43. Latitude did not submit with the industry submission and did not believe there was a workable solution to address multiple accounts, highlighting that a key challenge is that BNPL lenders have different definitions of when an instalment is overdue.

BNPL credit amounts being automatically increased

44. Some BNPL lenders have increased the amount of credit they offer users automatically, without a user's request, if the borrower demonstrates an ability to maintain repayments. 28 per cent of respondents to the Survey stated they delayed or missed essentials or bills, stated they did so because the amount of credit they were offered increased beyond what they could afford.

45. Ngā Tāngata Microfinance provided a case study of a BNPL user whose credit amounts were increased because they had begun using BNPL regularly and who subsequently suffered financial hardship as they could not afford the credit they were given.

Missed payments and late fees

46. Users of BNPL may be charged a late fee if they miss an instalment. Fees range from flat fees to a percentage of the value of the transaction. Typically, these fees are capped.

47. Financial mentoring service submitters agreed that late fees can worsen financial hardship. Christians Against Poverty (CAP) noted that several of its clients had their debts passed on to collection agencies when they missed instalments.

48. CAP also noted that it can be hard for consumers to contact BNPL lenders to discuss hardship and in the meantime late fees continue to accrue.

Timing of instalments

49. 60 per cent of respondents to the Survey stated they had missed instalments or delayed other expenses because of the timing of their BNPL instalments occurred at same time as other expenses.

50. The majority of financial mentors also raised this as an issue in submissions to our consultation with FinCap noting that inconsistencies with the timing of instalments was the most common BNPL concern cited by mentoring services it works with.

Use of credit cards to pay instalments

51. Almost 20 per cent of respondents to the Survey stated they pay their BNPL by credit card, which can result in the consumer incurring additional interest and could potentially result in, or exacerbate, financial hardship.

Promotion of BNPL

52. Salvation Army noted that BNPL services advertise widely through social media and that clients reported that they only used BNPL services because they saw these advertisements, highlighting that the Mad Butcher specifically advertises the ability to pay with BNPL. Concerns have also been raised about the ability for consumers to use BNPL to purchase alcohol.

53. 30 per cent of respondents to the survey stated they had missed instalments or delayed other expenses because they got enticed by BNPL marketing and bought more than they could afford. While 30 per cent said they focused on the first instalment rather than the cost.

What objectives are sought in relation to the policy problem?

54. As outlined in the discussion document, the Government's overall objective is that the BNPL sector delivers long-term benefits to consumers. These benefits may occur:

- directly to consumers who use BNPL
- indirectly to consumers, including to those that do not use BNPL, through the competition and innovation that BNPL creates across the financial system.

55. To deliver long-term benefits to consumers, we consider that the interests of BNPL consumers should be protected so that they are confident and informed participants in a transparent, competitive, and innovative BNPL sector.

56. For the sector to deliver long-term benefits to consumers, we consider that the causes and exacerbators of financial hardship discussed in Section 1 need to be addressed by ensuring that BNPL is:

- focused on consumers who are able to afford purchases
- suitable to the needs of the consumer.

Ensuring consistency across BNPL lenders to deliver long-term benefits to all consumers

57. As can be expected in a new rapidly evolving sector, there is likely to be variability in how different lenders with different market segmentation are dealing with customers experiencing financial hardship. Some BNPL lenders already have some policies and processes in place to address some of the features which worsen financial hardship.

58. However, we consider that all BNPL lenders need to take consistent steps to minimise financial hardship so that the sector delivers long-term benefits to consumers.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

59. The criteria used to compare the options are as follows

- **effectiveness (double weighted):** the extent to which the option protects consumers from financial hardship.
- **ease of implementation:** the ease of lenders to implement changes which comply with requirements of the option.
- **access to low-cost credit:** the extent to which the option continues to provide for access to credit at low or zero cost.

60. These criteria were selected because, in addition to protecting the interests of consumers, we consider it necessary to ensure that the BNPL sector and wider credit markets are competitive and innovative for the long-term benefits of consumers.

61. We have double weighted effectiveness as consumer harm is the key problem we are trying to address, as well as to account for consumer harm increasing as BNPL continues to grow in popularity.

What scope will options be considered within?

62. This RIS considers the options canvassed in the discussion document as well as additional permutations of these designed to address issues raised in submissions. This ranges from non-intervention to self-regulation as well as options to regulate under the CCCFA.

63. Separate legislation has been ruled out as the powers to regulate under the CCCFA are relatively flexible meaning bespoke legislation would not be necessary.

64. The approach of other jurisdictions was taken into account when considering options, however we understand that New Zealand is further ahead in its policy development than other jurisdictions, with the exception of Australia who have taken an industry code approach.[5]

65. Although a mandatory industry code has been considered, a voluntary industry code has not, as attempts by the industry to develop a code have stalled and we do not consider it to be a viable option.

66. **What options are being considered?**
This RIS considers the following options:

- Option One: Status Quo/Counterfactual
- Option Two: Apply the CCCFA BNPL, with full affordability assessments
- Option Three: Apply the CCCFA to BNPL, with no affordability assessments
- Option Four: Apply the CCCFA to BNPL, with light affordability assessments
- Option Five: Apply the CCCFA to BNPL, with full affordability assessments above $200
- Option Six: Apply the CCCFA to BNPL, with light affordability assessments above $600

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[5] It has recently been announced that the Australian Government plans to regulate BNPL arrangements.

- Option Seven: Mandatory industry code.

Option One – Status Quo: BNPL remains unregulated

67. Under this option, BNPL remains exempt from the CCCFA. We understand that several BNPL lenders in New Zealand began developing a voluntary industry code, however early drafts seen by officials in 2021 did not appear to address the causes financial hardship we have identified in Section 1.

68. Individual lenders may decide to address the causes of financial hardship identified and put into place policies to ensure that BNPL is focused on consumers who are able to afford purchases and suitable to their needs. However, this will reflect the individual priorities of BNPL lenders.

Access to low-cost credit

69. This option would have limited impact on credit markets.

Impact on financial hardship

70. This option does not guarantee that the causes of financial hardship will be addressed and that consumers will have appropriate support if they fall into hardship. As noted earlier, it is likely that there will be a lack of consistency across providers, meaning protection from financial hardship will depend on which BNPL lender a consumer has borrowed with.

Ease of implementation

71. There are no requirements for BNPL lender to implement anything under this option.

Stakeholder views

72. Financial mentors as well as banks were critical of this option during consultation. We expect financial mentors to continue to publicly oppose this option as all submissions from financial mentors strongly urged for Government intervention.

73. BNPL lenders would favour this option as well as any option where affordability assessments are not required.

Option Two: Apply the CCCFA BNPL, with full affordability assessments

74. Under this option, section 137A of the CCCFA would be used to declare BNPL arrangements to be consumer credit contracts, regulating BNPL arrangements in the same way as other forms of consumer credit.

Access to low-cost credit

75. Applying the CCCFA in full would require BNPL lenders to comply with the affordability regulations for all BNPL arrangements. Our analysis suggests that affordability assessments have a high cost to lenders Commercial Information this would also increase the application processing time which would make BNPL less attractive to consumers.

76. We heard from BNPL lenders that the additional costs may lead to them charging consumers for the credit or increasing the minimum amounts of credit on offer. BNPL lenders may also decide to exit the market. This option would likely decrease competition, increase the cost of borrowing, and reduce access to credit.

Impact on financial hardship

77. The CCCFA has several provisions which directly address the causes of hardship identified in Section 1:

- Affordability assessments would ensure that consumers are not given loans where they cannot afford the repayments This is the main driver of financial hardship as the actual cost of BNPL credit is very low.
- Disclosure rules require creditors to inform users upfront of the initial unpaid balance, total amount of credit offered, default, and other fees. Making consumers more aware of the nature of BNPL as a form of credit may reduce overspending by consumers as well as making BNPL arrangements more consistent with other credit products.

78. Other benefits to consumers would be the CCCFA's protections for consumers who fall into hardship:

- Section 41 provides that a consumer credit contract must not provide for a credit fee or default fee that is unreasonable. This would help limit the impact of late fees on increasing financial hardship as fees may be scrutinised by the Commerce Commission.
- Subpart 8 gives debtors a right to request a change to the terms of the consumer credit contract on the grounds of unforeseen hardship.
- Section 9C(3)(d) outlines that the lender must treat the borrower and their property (or property in their possession) reasonably and in an ethical manner, including— (i) when breaches of the agreement have occurred or may occur or when other problems arise.

Ease of implementation

79. Implementation would be difficult for BNPL lenders who would need to make significant changes to their business models in order to comply with the CCCFA affordability regulations.

Stakeholder views

80. Banks and non-bank lenders were supportive of this option both to address hardship from BNPL as well as to ensure the competitiveness of their existing CCCFA compliant products. Financial mentors also supported this option.

81. BNPL lenders were opposed to this option on the basis that it imposed costs that were disproportionate the amount of financial hardship in the BNPL market. This was mainly due to the prescriptive requirements of regulations in relation to affordability assessments. Providers did not raise significant issues with other requirements in the CCCFA.

Option Three – Apply the CCCFA to BNPL, with no affordability assessments

82. This option would apply the CCCFA to BNPL arrangements like option Two, however, lenders would be excluded from the requirement to assess affordability.

Access to low-cost credit

83. Access to low-cost credit would likely continue at the same level it exists now. BNPL lenders have indicated that they would not have to significantly change their business models to comply with CCCFA (except for the affordability requirements).

Impact on financial hardship

84. While further protections would be put in place, affordability assessments are the main protection against consumers borrowing more than they can afford. As such, any hardship that currently exists is likely to continue at a relatively similar level.

Ease of implementation

85. BNPL lenders have not indicated any difficulty in implementing the CCCFA other than carrying out affordability assessments.

Stakeholder views

86. Due to timeframes, we have not canvassed stakeholder views on this option. However, as BNPL lenders have indicated that they would have difficulty performing affordability assessments an exemption from this requirement would likely be welcomed.

87. While further protections will be welcomed by financial mentors, an exemption from affordability requirements would likely be seen as not providing enough protection from the core driver of financial hardship.

88. Other lenders would likely view exemption from the affordability requirements as providing a competitive advantage to BNPL providers. We note that existing lenders could chose to enter the BNPL market and compete under the same regulatory environment.

Option Four – Apply the CCCFA to BNPL, with light affordability assessments

89. This option would apply the core CCCFA to BNPL arrangements like Options Two and Three. However, lenders would be excluded from the detailed affordability assessment process prescribed in CCCFA regulations.

90. BNPL lender's affordability assessments would still need to comply with section 9C(3)(a) of the CCCFA which requires lenders to make reasonable inquiries so as to be satisfied that the borrower will likely make the payments under the agreement without suffering substantial hardship. This would allow BNPL lenders to develop their own processes and approach to comply with the affordability principle of the CCCFA.

Access to low-cost credit

91. This option would still impose further costs on BNPL lenders which we believe cannot be absorbed in their current business model. This would likely lead to lenders exiting the market, charting fees or increasing the minimum loan amounts.

92. There would likely be a mix of each of the three options above. Where lenders predominantly choose to exit the marker or charge fees, access to low-cost credit will decrease.

93. This option may result in legal obligations that are unclear for BNPL lenders. One of the key findings of the 2018 review of the CCCFA (before the 2020 and 2021 amendments were made) was that the principles-based nature of the requirements was identified by stakeholders as contributing to problems with noncompliance, despite guidance in the Responsible Lending Code.

94. Further changes to the CCCFA made in 2020 should address some of these issues - For example, requirements for lenders to keep records that substantiate that loans are affordable, the removal of the blanket ability for lenders to rely on borrower statements (unless they have reasonable grounds to believe the information is not reliable), and the enhanced liability regime. This will incentivise BNPL lenders to improve compliance and better equip the Commerce Commission to carry out its monitoring and compliance functions in respect of BNPL lenders.

Impact on financial hardship

95. These assessments would provide some protection for BNPL users, however it is not clear how robust these assessments would be, if lenders choose to lend higher amounts to recover costs, it would exacerbate risks of overspending already present in BNPL.

Ease of implementation

96. While lenders would have to design their own affordability assessments, we assume they would design assessments easier to implement than the full CCCFA affordability assessments.

Stakeholder views

97. Due to timeframes, we have not canvassed stakeholder views on this option. However, BNPL lenders submissions on our discussion document emphasised the importance of a proportional response to financial hardship caused by BNPL and this approach is likely to raise major concerns due to the need to carry out affordability assessments on many low value loans.

98. It is unclear what views financial mentors and other stakeholders may have; however, any further protections are likely to be welcomed. There may be concerns that full affordability assessments are not required for BNPL arrangements.

Option Five – Apply the CCCFA to BNPL, with full affordability assessments above $200.

99. This option would apply the CCCFA to BNPL arrangements like Options Two, Three and Four however the lenders would only be required to assess affordability in line with the CCCFA on credit over $200.

100. For amounts of credit below $200, BNPL lenders would have to obtain a credit report from applicants.

101. All other CCCFA obligations noted in Option Two would continue to apply regardless of the size of the loan.

Access to low-cost credit

102. BNPL lenders would have to change their business model to comply with this option. In our view the possible options BNPL lenders may take are as follows:

- **Scenario 1 - Cease to offer credit over $200**. This would greatly reduce revenue but keeps variable costs low.
- **Scenario 2 - BNPL lenders start to recoup costs using fees and interest**. Charging fees and interest would automatically result in BNPL lenders being regulated under the CCCFA, meaning affordability assessments would be required on all BNPL arrangements.
- **Scenario 3 - A two-tiered model**. BNPL lenders would offer a low credit product with no fees or interest, and higher credit product subject to more rigorous checks and fees or interest.
- **Scenario 4** - **Exiting the market.** BNPL lenders decide there is no pathway to sufficient profitability and exit the market.

103. It is unlikely that every lender would choose the same scenario and the market is likely to be defined by a mix of the above scenarios.

104. Scenario 1 maybe untenable for lenders as the limitations on revenue may be too restrictive to allow BNPL to operate profitably. The average maximum credit amount of $592 is well above what they could offer in Scenario 1 and many lenders have recently

increased their starting maximum amounts to allow more or larger transactions and earn more revenue.

105. As such, the BNPL market is likely to be dominated by a mix of Scenarios 2, 3 and 4. Each of these scenarios:

- limits the availability of credit
- increases the cost of credit
- potentially pushes people to more expensive forms of credit, such as credit cards and personal loans.

106. Based on this, we consider that this option would have the effect of removing many of the benefits BNPL currently confers on consumers.

Impact on financial hardship

107. This option would lower the risk that credit is provided to those who cannot afford it by using credit reports to inform lending decisions for credit amounts under $200.

108. For credit amounts over $200, affordability assessments would reduce the amount of people who get access to credit and reduce the total amount of people in financial hardship due to unaffordable BNPL arrangements. If BNPL lenders seek to recoup additional costs from borrowers this option could worsen financial hardship for any borrowers that fail to make their repayments.

Ease of implementation

109. As we believe most BNPL lenders will not cap the amount they lend to $200, lenders would likely have to implement the CCCFA affordability regulations which would require significant changes to their business models.

Stakeholder views

110. While we have not canvassed stakeholder views on this option, in their submissions, BNPL lenders emphasised the importance of a proportional response to financial hardship caused by BNPL and this approach is likely to raise major concerns.

111. It is unclear what views financial mentors and other stakeholders may have; however, any further protections are likely to be welcomed. There may be concerns that full affordability assessments are not required for BNPL arrangements below the threshold.

Option Six – Apply the CCCFA to BNPL, with light affordability assessments above $600

112. This option takes a threshold approach similar to Option Five. Affordability assessments would only be required for amounts of credit higher than $600. The affordability assessments above $600 would be similar to those in Option Four and be less onerous than the requirements in Options Two and Five.

Access to low-cost credit

113. Under this option, the range of scenarios chosen by BNPL lenders may be a mix of all the scenarios discussed in paragraph 102 above (with Scenario 1 being modified to a level of $600).

114. Scenario 1 (ceasing to offer credit over $600) would be more tenable under Option Six as $600 is not far off the current the average maximum credit amount of all providers (and higher than the individual average maximum of some providers). However, BNPL lenders choosing this strategy would be unable to increase revenue per customer by raising credit limits further.

115. Above this level, lenders would develop their own pathways to compliance. Lender's approach to affordability assessments may vary but we assume that at least some lenders will develop assessments which are less costly than would be required by the

regulations. Reducing the cost of carrying out these checks reduces the costs that BNPL lenders would need to recover through increased fees charged to merchants, or fees or interest charged to consumers. This should make Scenario 2 less likely and therefore not reduce the ability of consumers to access low-cost credit.

116. The extent to which BNPL lenders would exit the market (Scenario 4) is also unclear under this option. Any increased compliance costs could incentivise BNPL lenders, all of whom are not currently profitable, to leave the market. However we consider other scenarios are more likely under this option.

117. Overall, this option would decrease the availability of credit and increase the cost of credit and could push some consumers to more expensive credit – but all to a lesser extent than under Options Two, Four and Five.

118. Allowing flexibility increases the viability of BNPL and reflects its unique characteristics.

Impact on financial hardship

119. The exact processes lenders develop will impact the amount of reduction in financial hardship. Increased affordability checks will reduce the amount of people using BNPL when they cannot afford it and so will reduce the amount of people in financial hardship as a result of BNPL.

120. Like Option Four, this option may result in legal obligations that are unclear for BNPL lenders and difficult to enforce. The changes made to the CCCFA in 2020 should address some of these issues.

Ease of implementation

121. As with Option Five, if BNPL lenders only offered credit below $600, implementation would be relatively simple. For lenders who offer credit over $600, lenders would have flexibility to implement affordability assessments. We assume they would design assessments easier to implement than the full CCCFA affordability assessments.

Stakeholder views

122. No stakeholder views have been canvassed on this option. One BNPL lender did submit that it would be able to undertake affordability assessments in line with requirements similar to this but would not be able to comply with the affordability regulations which would be required by Option Two and Five.

Option Seven – Mandatory Industry code

123. Under this option, the government would work with BNPL lenders to establish a mandatory industry code. The industry code would be focused on ensuring consumers are able to afford purchases and that BNPL is suitable for the needs of the consumer on an on-going basis, whilst ensuring there is sufficient flexibility for the sector to continue to innovate and provide competition. The code could be made mandatory by applying the CCCFA to BNPL and exempting BNPL lenders based on their compliance with the code.

Access to low-cost credit

124. We assume that the content of any code would be aimed at providing a ‘minimum viable product’ and therefore provide fewer protections than under the CCCFA but would require BNPL lenders to carry out checks beyond what is required under the status quo. This could mean the lenders carry out credit checks, but not other checks (e.g. income verification).

125. Based on these assumptions there is a range of possible impacts on credit markets, but these would likely range from a mild reduction in access to interest free credit to a medium reduction.

Impact on financial hardship

126. The code previously drafted by BNPL lenders (based on the Australian industry code), focuses on the needs of lenders to reduce defaults rather than a more fulsome view of financial hardship, meaning that hardship which is less easy to identify, such as consumers delaying or going without essential goods, may not be addressed or even visible to providers.

127. The Government could make additions to this to strengthen protections but for this option to remain different to the other options proposed we assume that protections would be weaker than other options.

Ease of implementation

128. Though the content of any code is uncertain we can assume it would be tailored to make implementation simple for providers.

Stakeholder views

129. In our original consultation, BNPL lenders were particularly supportive of this option.

How do the options compare to the status quo/counterfactual?

Criteria	Option One Status Quo / Counterfactual	Option Two Apply the CCCFA BNPL, with full affordability assessments	Option Three Apply the CCCFA to BNPL, with no affordability assessments	Option Four Apply the CCCFA to BNPL, with light affordability assessments	Option Five Apply the CCCFA to BNPL, with full affordability assessments above $200	Option Six Apply the CCCFA to BNPL, with light affordability assessments above $600	Option Seven Mandatory industry code
Effectiveness (double-weighted)	0 Financial hardship from BNPL is likely continue.	++ Addresses causes of financial hardship.	0 Provisions focus on helping those once in hardship, not before.	+ Addresses causes of financial hardship.	++ Addresses causes of financial hardship.	+ Addresses causes of financial hardship.	0 Depends on drafting of the code.
Ease of implementation	0 Nothing required.	- - Many requirements, no flexibility.	- Minimal requirements.	- Lenders design own affordability assessments based on their understanding of the principle.	- - Many requirements, minimal flexibility.	- Lenders design own affordability assessments based on their understanding of the principle or choose to not supply credit above the threshold.	0 Drafting would likely aim to make implementation easy.
Access to low-cost credit	0 No change.	- - Will decrease access to low-cost credit.	0 There should be limited cost in implementing and complying with the non-affordability CCCFA obligations.	- May be reduced access to low-cost credit if BNPL lenders make conservative decisions.	- - Will decrease access to low-cost credit.	0/- May reduce access to low-cost credit if BNPL lenders make conservative decisions.	0/- Depends on the content but further checks may decrease access to credit.
Overall assessment	0	0	1-	0	0	0/1+	0/1-

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What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

130. On the basis of our assessment against the criteria, Options Two, Four and Five are likely to reduce the risk of financial hardship, but are likely to be costly to implement, increase the cost of borrowing and reduce access to low-cost credit. Options One and Three are unlikely to materially reduce the risk of financial hardship. Option Seven may slightly reduce access to low-cost credit but is unlikely to do so significantly. However this option is also unlikely to materially impact hardship unless further checks are in place (in which case it begins to look somewhat like the other options).

131. Based on the information we currently have, Option six is the most likely to strike the balance between reducing the risk of hardship, and ensuring that consumers can continue to access this low-cost form of credit.

What are the marginal costs and benefits of the option?

Option Six

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups	Costs of CCCFA compliance and credit checks.	Medium	Medium – Stakeholders have provided estimates on costs
Regulators	Marginal increase in FTE due to an increase in guidance, monitoring and investigations in an area that hasn't required it. The Commerce Commission regulates hundreds of creditors. There are currently six BNPL lenders who would be added to this pool of regulated entities.	Low	Medium
Others (eg, wider govt, consumers, etc.)	Some consumers may have access to credit reduced. Consumers will need to undergo additional checks when using BNPL	Medium	Low

	Businesses that use BNPL may see reduced revenue.		
Total monetised costs			
Non-monetised costs		Medium	Medium
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Lower defaults from better lending information.	Low	Low – Lending decisions are opaque, so change is hard to assess.
Regulators	More accurate and reliable information about the BNPL sector.	Low	Low
Others (eg, wider govt, consumers, etc.)	Consumers will be better protected. Consumers will be able to build positive credit history of BNPL. Other lenders will have more accurate credit reports which will enable them to make better lending decisions.	Medium	Low
Total monetised benefits	-		
Non-monetised benefits		Medium	

Section 3: Delivering an option

How will the new arrangements be implemented?

132. These changes will be given effect by regulations under the CCCFA. Prior to implementation, we consider it necessary to carry out further consultation on an exposure draft of the regulations. We will use this consultation to determine the appropriate level of the threshold, and what obligations should apply above the threshold. This will provide more certainty about the likely costs and benefits of the options and ensure that the final design delivers on the objectives.

133. It is anticipated that amendment regulations will be made in mid-2023 and come into force late-2023.

134. Some lenders have estimated that implementing affordability assessments as required by Options Two, and Five may take six to 12 months. This can be partially mitigated by the threshold approach of Options Five and Six as BNPL lenders could still offer credit at a similar level now with some adjustments to undertake credit inquiries and reporting. Options Four and Six also partially mitigate this by lessening the requirements that BNPL lenders will have to implement.

135. Changes are also likely to be required to the Responsible Lending Code, which provides non-binding guidance on the CCCFA and Regulations. This will be developed at the same time as the Regulations.

136. The credit reporting industry body (RCANZ) has already established data standards to support BNPL data being shared with other credit products and implemented in the credit system and several BNPL lenders already report into this system.

137. As with the CCCFA changes, the Commerce Commission will also have an important role in educating BNPL lenders and other stakeholders about the new requirements. For the CCCFA changes, the Commission ran a number of well-attended lender seminars on their interpretation and enforcement approach in respect of the Regulations.

How will the new arrangements be monitored, evaluated, and reviewed?

138. We intend to check in with key stakeholders soon after any further changes to regulations to find out what changes are being made to processes, and the impacts of these on lending and borrowers.

139. Additionally, the Cabinet paper includes a commitment from the Minister to reviewing the arrangements one year after they have come into force.

140. We have previously asked lenders for information which can be used as a baseline for MBIE to assess any changes in response to the new arrangements. Information from these requests which is relevant to the objectives covered in this RIS include:

- arrears and default rates
- average maximum amounts of credit for customers
- transaction volumes
- default fees.

141. The Commerce Commission also has a role under section 110 of the CCCFA to monitor trade practices in credit markets.