MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Dr Duncan Webb	**Portfolio**	Commerce and Consumer Affairs
Title of Cabinet paper	Fit for purpose regulation of consumer credit	**Date to be published**	9 August 2023

List of documents that have been proactively released		
Date	**Title**	**Author**
2 August 2023	Fit for purpose regulation of consumer credit	Office of Minister of Commerce and Consumer Affairs
7 August 2023	Fit for purpose regulation of consumer credit CAB-23-MIN-0348.01	Cabinet Office
26 July 2023	Revised Regulatory Impact Statement: Applying the Credit Contracts and Consumer Finance Act in a proportionate way to buy now pay later lenders	MBIE

Information redacted **YES**

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 lenders

Coversheet

Purpose of Document	
Decision sought:	*The Minister proposes to apply the Credit Contracts and Consumer Finance Act to buy now pay later arrangements with exemptions from certain requirements.*
Advising agencies:	Ministry of Business, Innovation and Employment
Proposing Ministers:	Minister of Commerce and Consumer Affairs
Date finalised:	*26 July 2023*

Problem Definition
Buy now pay later is causing or worsening financial hardship for some consumers.

Executive Summary

This Regulatory Impact Statement (**RIS**) replaces an earlier RIS finalised on 19 October 2022 titled "Regulatory Impact Statement: Applying the Credit Contracts and Consumer Finance Act in a proportionate way to buy now, pay later arrangements". Feedback from consultation on our earlier proposal led us to revise our options.

This updated RIS provides information and revised options to apply the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) in a proportionate way to buy now pay later (**BNPL**) lenders.

Following concerns about BNPL causing or worsening financial hardship the Government agreed to apply the CCCFA to BNPL in October 2022. The Government also agreed to exempt BNPL lenders from assessing affordability for loans under a threshold amount. As part of this, BNPL lenders would be required to participate in credit reporting.

The Ministry of Business, Innovation and Employment (**MBIE**) opened consultation on 19 December 2022 to obtain feedback on the proposed regulations (the **Draft Regulations**), including a proposed threshold of $600 above which affordability assessments would be required. We also consulted on whether the affordability assessment would be a 'full' affordability assessment, in accordance with the Affordability Regulations, or a 'principles-based' affordability assessment that would be more limited, while remaining in accordance with the affordability assessment obligation in section 9C(3)(a)(ii) of the CCCFA.[1]

[1] To make reasonable inquiries, before entering into the agreement, and before making a material change... so as to be satisfied that it is likely that... the borrower will make the payments under the agreement without suffering substantial hardship.

Submitters broadly agreed with regulating BNPL. However, submissions were polarised as to what extent the affordability assessment requirements under the CCCFA should apply to BNPL. Financial mentors, charities and non-BNPL lenders noted that BNPL should be fully regulated under the CCCFA like other credit, while the BNPL industry submitted that many aspects of the CCCFA, particularly the affordability regulations, were disproportionate for small amounts of interest-free credit.

It is also important to note that it remains difficult to demonstrate a clear relationship between BNPL and financial hardship as no substantial quantitative data exists due to the relative newness of the sector and difficulty in assigning causation.

We have used the evidence from submissions to further analyse modified options to apply the CCCFA to BNPL. The options identified were:

- Option One: status Quo/counterfactual
- Option Two: apply CCCFA to BNPL with Comprehensive Credit Reporting (**CCR**) in place of affordability assessments
- Option Three: apply CCCFA to BNPL, using limited affordability assessments
- Option Four: apply CCCFA to BNPL, with full affordability assessments for contracts above $600
- Option Five: apply CCCFA to BNPL, with full affordability assessments above high-level threshold (e.g. $1000 or $1500).

This RIS concludes that Option 2 is most likely to achieve our objectives and lowers the risk of increasing the cost of credit for consumers. Should Option 2 be ineffective at reducing financial hardship, additional regulation could be applied if further analysis supports this. This option provides a measured step in the right direction while balancing the need to keep the industry competitive and ensure consumers can continue to experience the benefits of this no-interest lending product.

This option will bring BNPL lenders into the CCCFA, with important consumer protections such as disclosure obligations, requirements for reasonable default fees and for directors and senior managers to be certified as fit and proper persons, as well as lender responsibility obligations such as to treat a borrower ethically. Affordability assessments could be reconsidered in the future if hardship is not mitigated, once other initiatives such as the consumer data right (**CDR**) are in force.

Limitations and Constraints on Analysis

The BNPL sector is relatively new and after a period of high-growth is now in a consolidation 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. 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. While it surveyed a relatively large number of users, it 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 and 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 of the cost of assessing affordability and we have based our assumptions on the estimate we received which seems most plausible.

While we understand the cost of obtaining a credit report is relatively low, we have limited information on the cost of setting up comprehensive credit reporting. We are aware that two BNPL lenders have already done this, which suggests the cost is not unreasonable.

Responsible Manager(s) (completed by relevant manager)
Glen Hildreth Manager, Consumer Policy Ministry of Business, Innovation and Employment 26 July 2023

Quality Assurance (completed by QA panel)	
Reviewing Agency:	MBIE's Regulatory Impact Analysis Review Panel
Panel Assessment & Comment:	MBIE's Regulatory Impact Analysis Review 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 three payments of $25 at fortnightly intervals thereafter. The merchant receives $100 for the item less any fees (e.g. if fees are set at five 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 BNPL is not covered by existing consumer credit laws?

6. As BNPL lenders 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.

How is other consumer credit regulated?

7. Consumer credit is regulated under the CCCFA which includes several protections for borrowers, including:
   - Section 9C(3)(a)(i) requires lenders make specific inquiries about the borrower’s needs and objectives, to help ensure the credit product is suitable.
   - Section 9C(3)(a)(ii) (the **Affordability Principle**) requires lenders to make specific inquiries in order to assess the borrower’s income and expenses, to be satisfied that the repayments are not likely to cause substantial hardship to the borrower. This provision is backed by a prescriptive process in the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020, which outline how lenders must conduct affordability assessments to ensure this principle is met.
   - Section 9C(3)(d) of the CCCFA outlines that the lender must treat the borrower and their property (or property in their possession) reasonably and in an ethical manner, including when breaches of the agreement have occurred or may occur or when other problems arise.

- Section 9CA requires lenders to keep records of the inquiries made as part of its affordability assessment and suitability assessment that demonstrate how they meet these requirements.

- Part 2 Subpart 8 of the CCCFA gives borrowers a right to request a change to the terms of the consumer credit contract on the grounds of unforeseen hardship.

- Section 41 of the CCCFA provides that a consumer credit contract must not provide for a default fee that is unreasonable. This will help limit the impact of late fees on increasing financial hardship.

- Part 5A requires that directors and senior managers of lenders are fit and proper to hold these positions.

8. Additionally, creditors are required to be part of dispute resolution schemes which provide borrowers with free dispute resolution should they have a complaint about their lender.

Who regulates consumer credit in New Zealand

9. The Commerce Commission is the regulator responsible for promoting compliance with the CCCFA. The Commerce Commission's functions under the CCCFA are to:
    - monitor trade practices in credit markets, consumer lease markets, and buy-back transaction markets
    - take prosecutions in relation to breaches of the CCCFA
    - take civil proceedings under the CCCFA
    - make available appropriate information for the guidance of consumers, creditors, lessors, transferees, and other interested persons in relation to promoting compliance with the CCCFA.

10. The Commission has no duty or obligation to take action in respect of any particular consumers. Consumers are able to take their own private proceedings for breaches of the CCCFA.

Work to regulate BNPL in other jurisdictions is ongoing

11. BNPL arrangements are not classified under existing consumer credit regulations in other jurisdictions. The UK for example has announced plans to amend its credit legislation to provide tailored regulation for BNPL. The Australian Government has recently announced its intention to amend its credit regulation act to cover BNPL loans while partially exempting them from responsible lending obligations. The exact form of the obligations that will apply to BNPL in Australia is still being developed.

BNPL lenders previously attempted to create an industry code

12. Several BNPL lenders in New Zealand attempted to develop a voluntary industry code, based on the Australian industry code.

13. A draft of the code was produced in 2021. In response, 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.

14. 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 the development of a code.

The Government decided to bring BNPL into the CCCFA

15. In October 2022, the Government agreed to apply the CCCFA to BNPL lenders and to consult on when and how affordability assessments would be carried out.

16. We consulted on draft regulations which proposed requiring affordability assessments for contracts over a threshold of $600, as well as a requirement to participate in comprehensive credit reporting (**CCR**) for loans under the threshold. Consultation ran from 19 December 2022 to 10 March 2023.

BNPL lenders have developed a new initiative called PayWatch

17. Confidentiality [redacted]

What is the policy problem or opportunity?

18. For many, BNPL provides a simple and cost-effective way of accessing credit. It offers broader benefits to business and competition in the lending sector. However, there is a concern that for some users it could result in financial hardship.

19. Financial hardship is a sustained state of having insufficient financial means to meet financial obligations and necessary living expenses. It is associated with stress, material deprivation and other negative impacts on wellbeing.

Benefits of BNPL

20. 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.

21. 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.

22. Additionally, the ability for consumers to spread out payments to streamline their cash flow and purchase higher-cost items that they might not otherwise be able to afford is also a benefit that is difficult to quantify.

Difficult to demonstrate a clear relationship between BNPL and financial hardship

23. The relationship between BNPL and financial hardship is complex. In theory, it could cause or worsen financial hardship. Both could occur when a consumer purchases non-essential goods and services and overextends themselves in their repayment obligations. Hardship could also be worsened when a consumer defaults and must pay late fees to the BNPL provider, or if BNPL payments cause the consumer to default on another obligation that incurs a penalty.

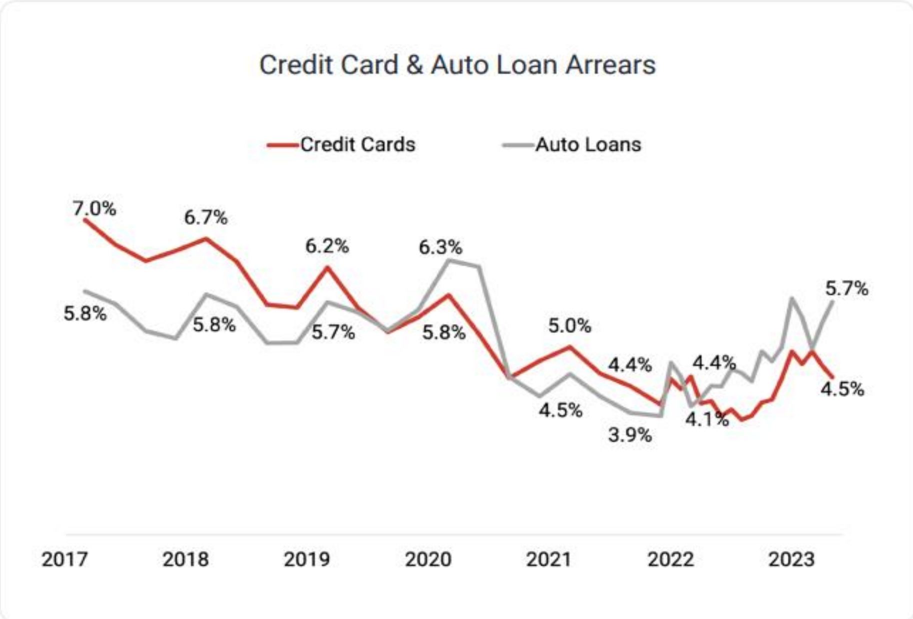
24. BNPL use may also be a symptom of hardship. This is because, where a consumer is struggling to afford essential goods, they may use BNPL to make the purchases. In this situation BNPL may either temporarily alleviate financial hardship or worsen financial hardship.

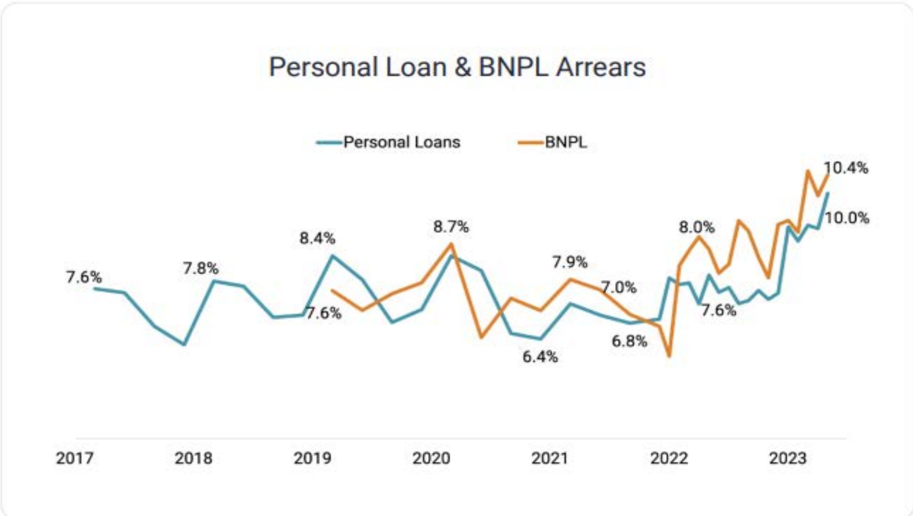
25. While we have data which is indicative of financial hardship, we do not have data that separates out the scenarios and provides clear evidence of financial hardship levels without BNPL or how regulation would impact this. Evidence of hardship continues to be limited and often anecdotal. When measuring hardship or considering case studies, it is difficult to ascertain whether instances of hardship among BNPL customers ultimately result from use of BNPL, other credit products, existing overspending behaviour, or existing poverty. A lack of financial capability may also contribute to difficulties with BNPL.

26. The information we have comprises data on where people are behind on BNPL payments, have missed multiple payments, go without essentials to make payments, or have sought help from financial mentors for financial hardship. It is important to note that comprehensive data identifying BNPL as a contributor to observed hardship is lacking. It is difficult to identify whether these consumers would end up in hardship using other payment or credit methods to make purchases.

Arrears are increasing

27. Information on repayment arrears is 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. The June 2023 monthly report from credit reporting agency Centrix shows 10.4 per cent of active BNPL accounts in arrears. The highest it has been was 10.5 per cent in April 2023, which compares with 4.5 per cent of credit cards in arrears and 10 per cent of personal loans in arrears. It is unclear whether this increase in arrears is due to the increase in the cost of living over this same period. BNPL arrears more closely track to personal loans as opposed to credit cards.





Source: Centrix credit reporting agency June 2023

Some consumers go without essentials to make BNPL repayments

28. In 2021, MBIE conducted a consumer survey with 1,781 respondents to a social media advertisement. Thirteen per cent of the current BNPL users surveyed said that BNPL had caused them to delay payment of bills or cut back on other essential expenses, or that they have missed three or more repayments. Forty-four per cent of respondents who no longer used BNPL said it was because they found it hard to stop purchasing more than they could afford. Consumers contacted were selected by a social media algorithm rather than randomly from the population. Given this methodology, and the self-selection effects associated with all surveys, the results may not be representative of BNPL users generally.

Financial mentors report an increasing proportion of their clients have BNPL debt

29. Financial mentors are a key stakeholder in the consumer credit area. They provide personalised budgeting advice to people who are struggling financially, often with large debt burdens.

30. Financial mentors have reported that BNPL debts are becoming much more common among their clients struggling with financial hardship and debt. Financial mentors have through FinCap, the recognised leadership body for financial mentors in New Zealand, provided information from their clients about the contribution of BNPL to financial hardship. One such example is someone on the Job Seeker benefit with BNPL repayments across four lenders, totalling far more than their weekly income. FinCap suggested this was a result of poor spending decisions rather than spending on essentials. Many examples also highlighted that people who already cannot afford essentials were using BNPL and stacking the loans, leading to high amounts of weekly repayments and ultimately further hardship if they cannot make payments and are charged late fees.

31. While people receiving financial mentoring services are not representative of the total population, these examples provide an insight into negative patterns of behaviour for some BNPL users.

32. Overall, data is inconclusive about the extent to which, if at all, BNPL contributes to financial hardship, although self-reported and anecdotal evidence suggests BNPL contributes to some extent in some cases.

What objectives are sought in relation to the policy problem?

33. The Government's objective is to reduce the risk of financial hardship being caused or worsened by BNPL (in comparison to the status quo) while ensuring that it remains viable and competitive as a low-cost alternative to traditional forms of credit. Balancing these two should protect the long-term interests of consumers overall.

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

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

34. The criteria we applied to assess the options were:

- effectiveness at lowering the risk of financial hardship
- confidence and participation (consumers can confidently participate and transact)
- compliance costs remain proportionate to ensure market remains competitive
- certainty of compliance requirements for both lenders and regulators.

35. The above criteria were selected because, in addition to lowering risks of financial hardship, we consider it necessary to ensure that the BNPL sector and wider credit markets are competitive and innovative for the long-term benefit of consumers. Additionally, providing lower cost credit should in theory drive other credit providers to innovate.

36. These criteria have been updated from our previous RIS to better reflect what we consider will drive the objectives outlined in Section 1. This change includes better balancing effectiveness at reducing financial hardship with the other criteria, directly addressing consumer confidence and participation, and reflecting that certainty of compliance obligations will support both consumer protection and the ability of regulated lenders to operate.

37. We have been unable to accurately determine the full cost of any of these options and have not received quantifiable estimates from BNPL lenders about the precise impact on their businesses given the detailed requirements are still being developed. As such we have considered the likely impact of each option relative to other options.

What scope will options be considered within?

38. This RIS considers some of the options proposed in the previous RIS along with additional permutations of these designed to address issues raised in submissions.

39. Separate legislation has also been ruled out as we consider that BNPL is sufficiently similar to other consumer credit contracts to justify its regulation under the CCCFA. The powers to regulate under the CCCFA are sufficiently flexible to enable the requirements to be adjusted.

What options are being considered?

40. Following the consideration of submissions and further meetings with BNPL lenders, we have re-considered options for when affordability assessments should be required, as well as the possible form of these assessments. This RIS considers the following options:

- Option One: status quo/counterfactual
- Option Two: apply CCCFA to BNPL with Comprehensive Credit Reporting (**CCR**) in place of all affordability assessments
- Option Three: apply CCCFA to BNPL, using limited affordability assessments
- Option Four: apply CCCFA to BNPL, with full affordability assessments for contracts above $600
- Option Five: apply CCCFA to BNPL, with full affordability assessments above high-level threshold (e.g. $1000 or $1500).

41. Options Two to Five also exempt BNPL lenders from the requirement to assess suitability under the CCCFA. We view this exemption as having little impact on financial hardship as suitability requirements would likely be of little benefit to BNPL applicants.

Unlike with other lending products, BNPL products are sold offered under varying terms, meaning that one BNPL product is unlikely to be more or less suitable than another.

Option One – Status Quo (No Action)

42. Under this option, BNPL remains exempt from the CCCFA. It would rely on the industry to self-regulate, for example through the development of a code of conduct (which we understand was under development in 2021) and measures such as PayWatch. Early drafts of a code seen by officials in 2021 did not address financial hardship caused by unaffordable loans.

Criteria	**Assessment**
Effectiveness at reducing financial hardship	While lenders have commercial incentives to take steps to avoid unaffordable borrowing, there will continue to be a risk that borrowers end up in financial hardship as a result of unaffordable lending. The development of PayWatch can be expected to reduce financial hardship being worsened for some BNPL users, although it does not protect against unaffordable loans being given in the first place and does not include information about other credit arrears.
Confidence and participation in BNPL	All BNPL lenders are currently registered with dispute resolution providers. Lenders will not be required to undergo any checks or meet disclosure and other CCCFA obligations.
Compliance costs	No additional compliance costs.
Certainty	Compliance obligations remain clear for lenders.

Option Two – Apply CCCFA to BNPL, with CCR in place of affordability assessments

43. This would require all BNPL lenders to get a comprehensive credit report on the applicant when they sign up as well as before credit limits are increased. BNPL lenders would have to contribute their lending information back into the CCR system. CCR provides information on borrower's current credit commitments as well as their repayment history for previous and current credit commitments.

44. Credit reporting identifies those who have been good at repaying credit and those who have previously had issues repaying credit, as opposed to an assessment of a person's ability to pay the required payments for any loan. This differs from affordability assessments laid out in other options which aim to assess a borrower's ability to pay.

45. Under this option, BNPL lenders would be exempt from the lender responsibility principle to make reasonable inquiries into the affordability of a loan. As a condition of this exemption, lenders would be required to have a policy detailing how they will use this information in lending decisions. As part of its regulatory powers the Commerce Commission would have the ability to request these credit policies as well as to ensure adherence to them. The credit policies will also help policy makers understand how credit reporting is being used in lending decisions. This further information about a potential borrower's credit situation is expected to reduce the amount of loans given to those already in debt or who have previously struggled repaying debt.

46. During consultation, BNPL lenders submitted that this option was unfair, as no other industry is required to participate in CCR in New Zealand. They also submitted that PayWatch can provide more timely information than CCR. Confidentiality

Confidentiality Following consultation, we understand that the cost of obtaining a credit report is not significant.[2] Some financial mentors also highlighted that varying information is held between credit reporting agencies and the system may be impacted if lenders rely on only one credit report.

47. PayWatch does not provide any information on an applicant's other borrowing obligations (apart from BNPL) and previous credit information. While we expect BNPL lenders to continue to use PayWatch where it benefits them, mandating CCR will require all lenders to check the financial commitments of applicants whether these are BNPL or other loans. Additionally, CCR participation will allow consumers to build improved credit scores through use of BNPL and will give BNPL lenders more information to base their loan decisions on.

48. The intent of this option is to improve lending decisions with better information for lenders while avoiding the higher compliance costs of other options.

Criteria	**Assessment**
Effectiveness at reducing financial hardship	While CCR will allow BNPL lenders to see whether an applicant is in arrears or has a large amount of other debt (including other BNPL debt), it is less effective than affordability assessments which aim to give a broader picture of an applicant's financial situation. CCR should reduce the risk of financial hardship compared to the status quo but not to the same extent as some of the other options.
Confidence and participation in BNPL	Consumer confidence would be increased compared to the status quo as further credit checks can help consumers build a positive credit score, disclosure should make their repayment obligations clear, and they will be able to access redress through dispute resolution schemes.
Compliance costs	Our understanding is that once set up, credit reporting under CCR has a minimal cost and should not interfere significantly with BNPL lenders' existing business models (i.e. point of sale applications).
Certainty	BNPL lenders will have a clear understanding of their obligations and will not be required to design affordability assessments as would be required under options three and four.

Option 3 - Apply CCCFA to BNPL, with limited affordability assessments for all BNPL loans

49. As with option two, this option would apply the CCCFA to BNPL arrangements. Lenders would be required to meet the lender responsibility principles. However, lenders would be excluded from the requirement to comply with the detailed affordability assessment process prescribed in the Affordability Regulations. There would be flexibility in how this is achieved so long as the principle is met.

50. As there is a lack of consensus on how a principles-based affordability assessment would operate, it would be necessary to provide guidance through the Responsible Lending Code to provide clarity on what would constitute a proportionate affordability assessment. This would be developed in consultation with industry, financial mentors, and the Commerce Commission. We anticipate that this guidance could be difficult to draft and could take some time to put in place, as there are polarised views on the appropriate level of assessments.

Confidentiality

Criteria	Assessment
Effectiveness at reducing financial hardship	This option would be more likely to reduce the risk of financial hardship than options one and two. Depending how it is designed, it could seek to provide more targeted protections for vulnerable borrowers.
Confidence and participation in BNPL	While additional assessments may increase trust in BNPL, it is likely that additional checks may turn some consumers away due to perceived intrusiveness. We note this will largely depend on the guidance provided.
Compliance costs	This option will require lenders to build systems to assess affordability, though the extent of these assessments (and their costs) will vary depending on the detail provided in guidance. Unlike option four, all lending will need to go through at least some affordability assessment so the compliance costs would be higher.
Certainty	Legal obligations under this option will be less clear than under other options, which could make it more difficult for the Commerce Commission to carry out its enforcement functions. However, guidance partially mitigates this risk.

Option 4 - Apply CCCFA to BNPL, with a threshold of $600 (as proposed in the Draft Regulations)

51. This option has all the elements of option two with additional requirements when borrowers are offered credit amounts above $600 (**the threshold**). The threshold would apply per lender. Above the threshold, lenders would have to undertake an affordability assessment in line with the CCCFA and the associated regulations. We consulted on both full affordability assessments and more principles-based assessments similar to option three. This RIS has analysed this option as applying full affordability assessments, due to a lack of consensus on how a principles-based assessment would operate. Affordability assessments as prescribed in the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 comprise time-consuming processes involving lenders verifying borrowers’ income and expenses to determine the affordability of a loan.

52. The aim of this approach is to balance access to small amounts of interest free credit with greater protections for consumers as credit amounts increase and may be more difficult to repay. Financial hardship would be reduced both through credit reporting for credit limits under the threshold, affordability assessments on credit limits over $600, and additional disclosure requirements.

Criteria	Assessment
Effectiveness at reducing financial hardship	This option provides limited protections for consumers under the threshold, which is arguably where some of the most vulnerable consumers are. CCR should partially mitigate this, but not to the extent affordability assessments would. Borrowers who borrow more than $600 would have greater protections through full affordability assessments.
Confidence and participation in BNPL	Consumers would likely have increased confidence due to extra disclosures and protections, but participation in credit limits above $600 might decrease as consumers may not want to provide the level of additional information required by the affordability assessment.
Compliance costs	BNPL lenders earn a very modest amount per loan[3], so it is possible the cost of affordability assessments could be overly burdensome if they are required to do this for all customers over a $600 limit. The cost of affordability assessments is substantial in relation to the size of BNPL loans and as such may lead lenders to exit the BNPL market, reducing access to low-cost credit, or to increase merchant fees which would be passed on to consumers.
Certainty	Legal obligations are clear. The additional affordability assessment requirements are prescriptively laid out in detail as part of existing regulations.

Option 5 - Apply CCCFA to BNPL, above a high-level threshold

53. This option takes a threshold approach similar to the option above, however full affordability assessments would only be required for amounts of credit much higher than $600 (e.g. $1000 or $1500).

54. A specific number has not been analysed for this option as based on the small size of most BNPL loans, there would be minimal difference in impact between a threshold of $1000 or any threshold above this.

Criteria	Assessment
Effectiveness at reducing financial hardship	While a higher threshold would provide less protections for consumers than a lower threshold, when combined with CCR for all credit limits below the threshold, this would reduce financial hardship compared with the status quo.
Confidence and participation in BNPL	Consumer confidence would be increased compared to the status quo as further credit checks and disclosure should make their repayment obligations clear. However, affordability assessments for larger loans may be onerous for BNPL users.
Compliance costs	BNPL lenders have indicated that they would be able to bear the costs of affordability assessments above a $1000 threshold, so unintended consequences (e.g. lenders exiting the market) are less likely than with a $600 threshold.
Certainty	Obligations would be relatively clear, similar to the $600 proposal.

[3] A US study suggests unit margins sit at around 1%. https://files.consumerfinance.gov/f/documents/cfpb_buy-now-pay-later-market-trends-consumer-impacts_report_2022-09.pdf

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

Criteria	Option One Status Quo	Option Two Apply CCCFA to BNPL with CCR in place of all affordability assessments	Option Three Apply the CCCFA to BNPL, using limited affordability assessments	Option Four Apply the CCCFA to BNPL, with full affordability assessments above $600	Option Five Apply the CCCFA to BNPL, with full affordability assessments with high-level threshold
Effectiveness (financial hardship)	0 While lenders would continue to have incentives to avoid unaffordable lending, this option is unlikely to materially reduce risk of financial hardship.	+ Reduces risk of financial hardship by filtering out people already in problem debt.	++ Addresses risk of financial hardship, but the extent to which it achieves this will depend on the design of the assessments.	++ Reduces risk of financial hardship below the threshold while better addressing the risk of financial hardship above the threshold.	+ Reduces risk of financial hardship below the threshold while better addressing the risk of financial hardship above the threshold. Less effective than Option Four due to the higher threshold.
Consumer confidence & participation	0 No change.	++ Increase in consumer confidence as borrowers will have access to better information about their loans. BNPL will continue to be a low-cost alternative to traditional lenders.	+ May increase consumer confidence if BNPL lenders make effective affordability assessments.	0 Slight increase in consumer confidence but requiring borrowers with loans above the threshold to undergo more onerous checks may dent confidence.	+ Slight increase in consumer confidence.
Compliance costs	0 No change.	- Lenders will be required to participate in CCR, but this option should be relatively straightforward for borrowers and less costly than affordability assessments.	-- Lenders will be required to implement systems to undertake affordability assessments for all loans.	-- Lenders will be required to implement systems to undertake affordability assessments on loans over $600.	- Lenders will have to assess affordability for loans over a higher-level threshold.
Certainty	0 No change.	0 Requirements are clear.	- There is a risk that lenders and regulators will have a lack of clarity of obligations. This could be mitigated though compliance.	0 Requirements are clear.	0 Requirements are clear.
Overall assessment	0	2+	0	0	1+

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

55. We recommend Option Two - exempting BNPL from both the Affordability Principle and the Affordability Regulations on the condition that they participate in CCR and have a credit policy in place. This option strikes the right balance between preventing consumers already in financial hardship from using BNPL, while not substantially increasing the burden on both lenders and consumers.

56. This option will bring BNPL lenders into the CCCFA, with important consumer protections such as disclosure obligations, requirements for reasonable default fees and for directors and senior managers to be certified as fit and proper persons, as well as lender responsibility obligations such as to treat a borrower ethically. Should Option 2 be ineffective at reducing financial hardship, additional regulation could be applied if further analysis supports this. Affordability assessments could be reconsidered if hardship is not mitigated in the future once other initiatives such as the consumer data right (**CDR**) are in force.

What are the marginal costs and benefits of the option?

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 identified a credit report costs in the low single digits (the exact number depends on the lender's arrangement/contract with the credit agency).
Regulators	Marginal increase in FTE due to an increase in guidance, monitoring and investigations. The Commerce Commission regulates hundreds of creditors. There are currently four BNPL lenders who would be added to this pool of regulated entities.	Low	Medium - The regulator (Commerce Commission) has provided feedback on the option.

Others (e.g. wider govt, consumers, etc.)	Some consumers may have reduced access to credit. Consumers will need to undergo additional checks when using BNPL.	Low	Medium
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.	Medium	Low – Lending decisions are opaque, so change is hard to assess.
Regulators	More accurate and reliable information about the BNPL sector.	High	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	High – Credit reporting systems are mature and well understood.
Total monetised benefits	-	-	-
Non-monetised benefits		Medium	Medium

Section 3: Delivering an option

How will the new arrangements be implemented?

57. These changes will be given effect by regulations under the CCCFA. It is anticipated that amendment regulations will be made in mid-2023 and come into force 12 months later. Transitional arrangements will be made to ensure current BNPL users do not have to undergo a credit check until their credit limit is increased.

58. These regulatory functions will be undertaken by the Commerce Commission as with other CCCFA regulation.

59. The Commerce Commission has been consulted on our preferred option and we anticipate that they can regulate the BNPL sector within their current fiscal budget due to the small amount of BNPL lenders and clear legal obligations.

60. Credit reporting is already regulated under the Credit Reporting Privacy Code as part of the Privacy Act 2020. The Code stipulates what information can be collected and how it

may be used. Two BNPL lenders already participate in credit reporting effectively. We have consulted with the Office of the Privacy Commissioner, which is supportive of this proposal.

61. As with recent 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?

62. 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.

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

64. We have previously asked lenders for information which can be used as a baseline 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.

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