

# Regulatory Impact Statement

## Regulations to exempt Voluntary Targeted Rate (VTR) schemes from provisions of the CCCFA relating to unforeseen hardship and unreasonable default fees

### Agency Disclosure Statement

- 1 This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.
- 2 It analyses options to address problems arising from the application of certain provisions of the Credit Contracts and Consumer Finance Act (CCCFA) to Voluntary Targeted Rate (VTR) schemes offered by local and regional councils. These provisions relate to:
  - a. Unforeseen hardship; and
  - b. Unreasonable default fees.
- 3 In submissions, councils noted that complying with these provisions would result in compliance costs that may be passed on to consumers and which may impact their willingness to offer the schemes. As a result, low-income ratepayers may lose access to low cost insulation and heating provided by the schemes. The extent of the changes needed to comply, and the level of the compliance costs, may differ between councils as councils administer the schemes independently. A constraint on this analysis is that councils have not provided estimates of the extent of the compliance costs or the number of low-income ratepayers who currently access VTR schemes.
- 4 Regulations are also currently being developed to exempt councils offering VTR schemes from other provisions of the CCCFA. These provisions relate to continuing disclosure, early repayment and charging of interest in advance. Cabinet approved these exemptions in 2012.

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## Status Quo

- 5 Voluntary Targeted Rate (VTR) schemes are consumer credit contracts offered by local and regional councils that allow ratepayers to retrofit their homes with insulation or a clean heating source<sup>1</sup> at a reasonable cost.<sup>2</sup> Councils administer the schemes and collect payments through the rating process to keep the administrative costs of the schemes low. This allows the schemes to be offered to low-income ratepayers<sup>3</sup>.
- 6 VTR schemes complement the Energy Efficiency and Conservation Authority's (EECA) *Warm Up New Zealand* initiatives which provide grants to help low-income homeowners to insulate or heat their homes.
- 7 VTR schemes provide significant public and private benefits. They support local government policies such as 'clean air' initiatives, and benefit individual ratepayers by enabling them to insulate or heat their homes at a reasonable cost. Warmer, drier homes provide health benefits for home owners which reduces the burden on the health system. Manufacturers and installers of insulation and heating products also benefit from the schemes.
- 8 Around ten local and regional councils offer VTR schemes to ratepayers, including Auckland Council, Wellington City Council and Greater Wellington Regional Council. The uptake of the schemes has been significant. For example, over 9000 participants have taken up Greater Wellington Regional Council's scheme alone.
- 9 Because VTR schemes are consumer credit contracts administered through the rating process there is a tension between how councils comply with the provisions of consumer credit legislation (the Credit Contracts and Consumer Finance Act 2003 (CCCFA)) in addition to the relevant legislation governing the collection of rates, which includes the Local Government (Rating) Act (LGRA). In some areas, the different sets of legislation set out conflicting or inconsistent requirements which result in councils being unable to technically comply without incurring unnecessary compliance costs or changing the way they administer the schemes. The level of these compliance costs, and the necessary changes, is uncertain. Councils have not provided estimates on the extent of compliance costs.
- 10 In 2012, Cabinet agreed to exempt VTR scheme providers from certain provisions of the CCCFA that they could not technically comply with. These provisions related to continuing disclosure, early repayment of interest and charging of interest in advance<sup>4</sup>. Regulations are currently being drafted to exempt councils from these provisions.

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<sup>1</sup> E.g. a heat pump, solar water heater, or heat pump water heater

<sup>2</sup> Interest rates on the schemes are currently around 7% p.a. The credit is usually repaid through rates over 9 – 10 years.

<sup>3</sup> In submissions, councils did not provide data on the number of low-income ratepayers who currently access the schemes.

<sup>4</sup> Regulatory Impact Analysis for these exemptions was carried out as part of analysis of the wider reforms to consumer credit legislation. The RIS can be found here:

<http://www.treasury.govt.nz/publications/informationreleases/ris/pdfs/ris-mbie-rccp-apr13.pdf>.

## **Problem definition**

- 11 Councils providing VTR schemes have requested that they be exempt from provisions of the CCCFA relating to unforeseen hardship and unreasonable default fees as these conflict with similar requirements set out under the LGRA. Councils have argued that if they are required to comply with these provisions they would likely incur unnecessary compliance costs which may be passed on to borrowers and may impact their ability to offer the schemes.

### *Unforeseen hardship provisions*

- 12 If a borrower repaying a consumer credit contract was to suffer financial hardship they can, in certain circumstances, seek relief from the lender. The unforeseen hardship provisions of the CCCFA outline that a borrower who is unable to meet the obligations of a credit contract due to factors including illness or loss of employment, is able to apply to the lender for certain changes to the credit contract. These changes include extending the term of the contract or postponing payments.
- 13 Councils provide relief to ratepayers experiencing financial hardship through rates remission and postponement policies. Remission of rates involves reducing the amount owing or waiving the collection of rates altogether. Postponement of rates means that the payment of rates is delayed for a certain time. The LGRA sets out how rates remission and postponement policies are to be implemented. Rates postponement policies are broadly similar to the unforeseen hardship provisions of the CCCFA which also allow for repayments under a credit contract to be postponed.
- 14 A key difference between these requirements is that the unforeseen hardship provisions of the CCCFA provide for specific remedies in certain circumstances while the rates remission and postponement policies under the LGRA are determined by each individual council.
- 15 Because VTR contracts are consumer credit contracts that are administered and repaid through the rating system, it is currently unclear how a council might offer relief given the inconsistent requirements of the CCCFA and LGRA for addressing hardship.
- 16 Councils state that they can only offer rates relief under their existing remission and postponement policies (which are offered to all ratepayers) and that the unforeseen hardship provisions of the CCCFA impose additional requirements that would increase the administrative costs and complexity of providing VTR schemes and threaten their willingness to offer them.

### *Unreasonable default fees provisions*

- 17 Under the unreasonable fees provisions of the CCCFA, any default fee applied to a consumer credit contract must not be unreasonable. In determining whether a default fee is unreasonable, the court must have regard to, in relation to the matter giving rise to the fee, whether the fee reasonably compensates the lender for any costs or losses they incur.

- 18 The LGRA states that any late payment fee cannot exceed 10% of the outstanding balance. In practice, local and regional councils generally charge a flat 10% penalty fee for late payment of rates. Because VTR schemes are administered through the rating cycle, and repayments are made with general rates payments, this flat 10% fee is applied to both the general rate and the small portion of the rates due that is attributed to repaying the VTR contract.<sup>5</sup>
- 19 Councils may not be technically complying with the unreasonable fees provisions of the CCCFA. Charging a flat 10% penalty fee on VTR credit contracts may be an 'unreasonable fee' under the CCCFA as it does not represent an amount required to reasonably compensate the lender for costs or losses arising from default. If councils are breaching the unreasonable fees provisions they could be subject to legal action from the Commerce Commission or a private individual.

## Objectives

- 20 The primary objective of this analysis is to ensure that councils continue to offer VTR schemes so that the benefits of the schemes will continue to be realised. To ensure this, any compliance costs or administrative burdens should be minimised. This must be balanced against ensuring that borrowers still have sufficient legislative protection from unreasonable practices. This is reflected in the primary purpose of the amended CCCFA to protect the interests of consumers in connection with credit contracts.
- 21 The policy options considered in this paper will be assessed against the following objectives:
  - a. Are consumers sufficiently protected under legislation from unreasonable practices?
  - b. Are the schemes able to be administered efficiently and effectively by councils, and are unnecessary compliance costs minimised?

## Options and Regulatory Impact Analysis

### Unforeseen hardship provisions

- 22 This section of the paper considers whether regulations should be developed to exempt councils from the unforeseen hardship provisions of the CCCFA. The options analysed are:
  - a. Option One: Require councils offering VTR schemes to comply with the unforeseen hardship provisions of the CCCFA; or
  - b. Option Two: Exempt councils offering VTR schemes from the unforeseen hardship provisions of the CCCFA (**Preferred Option**).

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<sup>5</sup> The proportion of rates repayments attributed to the VTR scheme are typically around 10-15% of overall rates payable.

23 The following table assesses these options against the objectives above:

Key:	
✓✓	Meets the policy objective
✓	Partially meets the policy objective
✗	Does not meet the policy objective

Objectives:	Option One: Require councils to comply with the unforeseen hardship provisions of the CCCFA	Option Two: Exempt councils offering VTR schemes from the unforeseen hardship provisions of the CCCFA (Preferred Option)
<b>Are consumers sufficiently protected under legislation from unreasonable practices?</b>	✓✓ Borrowers have sufficient avenues for relief if they suffer financial hardship. However, it is likely that existing council policies alone would be sufficient and that the additional layer of protection offered by the CCCFA is unnecessary.	✓✓ Although the provisions of the CCCFA provide for more specific remedy, it is likely that ratepayers are provided sufficient relief under the rates remission and postponement policies implemented by councils under the LGRA.  Although each council develops its own rates remission and postponement policies, these are broadly consistent between councils.
<b>Are the schemes able to be administered efficiently and effectively by councils, and are unnecessary compliance costs minimised?</b>	✗ Councils will have to develop and implement separate policies for rates relief under the LGRA and CCCFA. This will increase the administrative complexity of providing the schemes.  Developing and administering separate policies for relief under the LGRA and CCCFA would likely result in unnecessary compliance costs for councils. These costs may be passed on to borrowers.	✓✓ Exempting scheme providers from the unforeseen hardship provisions of the CCCFA enables councils to continue to offer rates relief under their existing policies to all ratepayers, including those with VTR contracts.  Councils will not incur the additional compliance costs associated with having separate relief policies for hardship under the LGRA and CCCFA.  Borrowers will continue to be able to apply

24 Officials recommend Option Two: to exempt councils offering VTR schemes from the unforeseen hardship provisions of the CCCFA.

25 If not exempt from these provisions, councils would have to develop and implement separate policies to allow for hardship relief under the CCCFA in addition to their existing rates remission and postponement policies. Councils advise officials that this would result in significant administrative complexity and compliance costs.<sup>6</sup> The portion of rates that is attributed to repaying the VTR contract is typically around 10-15% of the total amount, so implementing separate policies relating to this small amount would impose unnecessary additional costs.

26 Councils noted in submissions that if the administrative complexity or costs of VTR schemes were to increase they may no longer offer the schemes to ratepayers. As a result, the benefits of the schemes would no longer be realised.

<sup>6</sup> Quantitative information on the level of these costs was not provided by councils in submissions. However, councils have indicated that these compliance costs would be substantial.

- 27 While the grounds upon which a borrower can apply for relief are described differently under the unforeseen hardship provisions and rates remission and postponement policies<sup>7</sup>, it is likely that existing council policies provide sufficient relief for borrowers suffering hardship. Under these policies, councils can provide hardship relief to borrowers by reducing, waiving, or postponing the payment of rates.
- 28 The exact nature of these remedies (e.g. how long rates may be postponed for) is determined by each council independently. However, the policies are broadly consistent between councils. Officials are not aware of instances of councils undertaking unreasonable practices in relation to remitting or postponing rates in circumstances of financial hardship.
- 29 *Recommendation: Exempt councils offering VTR schemes from the unforeseen hardship provisions of the CCCFA.*

### Unreasonable fees provisions

- 30 This section of the paper considers whether councils offering VTR schemes should be exempt from the provisions of the CCCFA relating to unreasonable default fees. The options analysed are:
- Option One: Require councils to comply with the unreasonable fees provisions of the CCCFA; or
  - Option Two: Exempt councils offering VTR schemes from the unreasonable default fees of the CCCFA (**Preferred Option**)
- 31 The following table assesses these options against the objectives above:

Key:	
✓✓	Meets the policy objective
✓	Partially meets the policy objective
✗	Does not meet the policy objective

Objectives:	Option One: Require councils to comply with the unreasonable fees provisions of the CCCFA	Option Two: Exempt councils offering VTR schemes from the unreasonable default fees provisions of the CCCFA ( <b>Preferred Option</b> )
<b>Are consumers sufficiently protected under legislation from unreasonable practices?</b>	✓✓ Borrowers will be protected against unreasonably high default fees if councils are required to comply with the provisions of the CCCFA and LGRA. The default fee charged on general rates will be limited to 10% of the outstanding balance, and the default fee on the VTR portion would be based on reasonably compensating the lender for their costs or losses arising from the default.	✓✓ Borrowers will continue to be protected against unreasonable fees. The LGRA provides that late payment fees on rates must be no greater than 10% of the outstanding balance.

<sup>7</sup> The CCCFA sets out specific circumstances in which a borrower can apply for relief (e.g. illness, the end of a relationship or loss of employment) and sets out specific remedies that the lender can use to discharge the borrower's obligations, including extending the term of a contract or postponing payments. In contrast, rates remission and postponement policies, including the circumstances in which a borrower can apply, and the specific remedies that can be given (e.g. the term of postponement) are determined by the policies of each council.

**Are the schemes able to be administered efficiently and effectively by councils, and are unnecessary compliance costs minimised?**

✘

Councils would have to change their method of calculating default fees to allow for the default fee on the VTR credit contract to be calculated separately.

In calculating this fee, councils would have to calculate the costs and losses arising from the default of the VTR portion of rates. Currently councils do not have to do this calculation as they charge a flat 10% default fee.

The additional administrative complexity of calculating two separate default fees will increase the compliance costs of offering the schemes.

Given the 'user-pays' nature of VTR schemes, any compliance costs of calculating the fees under two sets of legislation would likely be added onto the late payment fee charged to the borrower.

✓✓

Exempting councils from the unreasonable default fees provisions allows them to continue to charge flat 10% late payment fees on all rates in line with the provisions of the LGRA.

The additional administrative complexity of also complying with the CCCFA would not be imposed.

Councils will not incur the additional compliance costs associated with calculating default fees under two sets of legislative requirements.

These compliance costs will not be passed on to borrowers.

- 32 Officials recommend Option Two: to exempt councils from the provisions of the CCCFA relating to unreasonable default fees.
- 33 The unreasonable default fees provisions of the CCCFA add additional requirements for calculating default fees that are inconsistent with the provisions of the LGRA. If councils were to comply with these provisions, they would need to change their method of calculating default fees to comply with both the CCCFA and LGRA. Councils would charge a flat 10% fee on general rates and calculate a separate default fee for the VTR portion of rates necessary to compensate councils for the costs and losses arising from the default of the consumer credit contract. This exercise would add an additional layer of administrative complexity to the transaction. Compliance costs would likely be passed on to borrowers.
- 34 If councils are exempt from the unreasonable fees provisions of the CCCFA, borrowers will still be protected from being charged exorbitant default fees as the LGRA limits default fees on rates to 10% of the outstanding balance.
- 35 *Recommendation: Exempt councils offering VTR schemes from the unreasonable default fees provisions of the CCCFA.*

## Consultation

- 36 On 5 September 2014, officials released a discussion document to councils, Local Government New Zealand, the Energy Efficiency and Conservation Authority and Commerce Commission. This sought views on regulations to exempt councils from provisions of the CCCFA relating to continuing disclosure, early repayment, calculation of interest and unforeseen hardship. Submissions broadly supported exemptions from these provisions due to the unnecessary compliance costs that would result from having to comply with the inconsistent requirements of both the LGRA and CCCFA.
- 37 Officials subsequently contacted councils to seek views on whether scheme providers may also require an exemption from the provisions of the CCCFA relating to unreasonable default fees. Councils supported an exemption from these provisions.

## **Conclusions and Recommendations**

- 38 We recommend that regulations be developed to exempt councils offering VTR schemes from the provisions of the CCCFA relating to unforeseen hardship and unreasonable default fees. In each case, these provisions add an unnecessary layer of administrative complexity to existing council policies under the LGRA. This would likely result in compliance costs that may increase the cost of the schemes to borrowers and/or may impact the willingness of councils to continue to offer VTR schemes.
- 39 It is unlikely that borrowers will be disadvantaged by the proposed exemptions. The existing provisions of the LGRA likely provide sufficient legislative protection for consumers in each case.

## **Implementation**

- 40 The proposed exemptions from the unforeseen hardship and unreasonable fees provisions will be drafted under section 138(1)(ab) of the amended CCCFA. These regulations will also implement the exemptions agreed to by Cabinet in 2012 to exempt VTR scheme providers from the provisions relating to continuing disclosure, early repayment and calculation of interest.
- 41 These exemption regulations are being developed in parallel with the implementation of the wider reforms to consumer credit law under the amended CCCFA. A Regulatory Impact Statement for the wider consumer credit reforms was completed in 2012.

## **Monitoring, Evaluation and Review**

- 42 These regulations will be monitored as part of overall monitoring and evaluation of the reforms to consumer credit legislation under the Credit Contracts and Consumer Finance Amendment Act.