



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 Minute	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.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Government Administration and Expenditure Committee

Preventing financial hardship caused by the use of Buy-Now, Pay-Later

Proposal

- 1 This paper seeks agreement to apply the Credit Contracts and Consumer Finance Act 2003 (CCCFA) to Buy-Now, Pay-Later (BNPL).

Relation to government priorities

- 2 This proposal to regulate BNPL supports the objectives of the Child and Youth Wellbeing Strategy to reduce child poverty by reducing financial hardship from BNPL.

Executive Summary

- 3 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). BNPL does not charge consumers interest or fees (except late payment fees) and is therefore not a 'consumer credit contract' under the CCCFA, and CCCFA protections do not apply.
- 4 BNPL can benefit consumers and competition by providing a convenient, low-cost alternative to traditional consumer credit products. However, there is evidence that BNPL can trigger financial hardship for some consumers.
- 5 Evidence from overseas and New Zealand indicates that the design and promotion of BNPL leads some consumers to enter into BNPL contracts that they cannot afford to repay. In an MBIE survey, 13 per cent of current BNPL users said that BNPL has caused them to delay payment of bills or forgo other essential expenditure, or that they have missed three or more repayments.
- 6 I consider that applying the CCCFA to BNPL in a proportionate way can better protect consumers from hardship, while retaining the benefits of BNPL. While applying the full CCCFA requirements to all BNPL would best protect consumers from risk of hardship, it is also likely to remove BNPL as a viable low-cost alternative to other credit products.
- 7 I therefore propose to apply the CCCFA to BNPL, but with an exemption from the requirement to conduct an affordability assessment for BNPL below a threshold credit amount. A condition of the exemption would be for the lender to obtain credit reporting information from a credit reporter, including information about open

accounts and repayment history, and to provide credit reporting information back into the system.

- 8 For BNPL above the threshold, I propose two options for affordability assessments be consulted on during the development of regulations. The first option is that BNPL lenders comply with the detailed affordability processes prescribed in the Credit Contracts and Consumer Finance Regulations 2004. The second option is that BNPL lenders are subject to the lender responsibility principle to make reasonable inquiries into the affordability of the loan, but are excluded from the detailed regulations. I also propose to consult on the value of the threshold, but consider that a threshold of around \$600 may be appropriate.
- 9 To address additional triggers of financial hardship which may not be sufficiently covered by the provisions in the CCCFA, I am also seeking agreement to introduce additional disclosure obligations as a condition of any exemptions or exclusions from CCCFA obligations. This would require BNPL lenders to make default fees (for missed or late instalments) and the timing of instalments clear to the consumer at the point of each purchase using BNPL.
- 10 I intend to release a public exposure draft of regulations in December 2022. I will report back to Cabinet on the outcome of consultation and bring final regulations to the Cabinet Legislation Committee for approval by the second quarter of 2023.

Background

Overview of how BNPL works

- 11 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) and payment is usually made through a debit or credit card.
- 12 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 BNPL 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 merchant fees are set at 5 per cent of the value of the item, the merchant would receive \$95 and the BNPL lender would receive \$5).
- 13 If the consumer is late or misses an instalment, the BNPL lender may charge the consumer a late payment fee. Fees range from flat fees, for example, \$10 for a missed instalment, to a percentage of the value of the transaction. Typically, percentage-based fees are capped at a maximum dollar amount, but there may not be a cap on the number of fees that can be incurred for an account. If credit cards

are used to make repayments, there is the risk of the consumer facing additional credit card fees.

- 14 Across the industry, the average BNPL transaction value was \$150.¹ Consumers can use BNPL for online goods, in-store transactions and, increasingly, for services such as dental treatment and vehicle repairs. The average credit limit for BNPL users was \$592.

Overview of BNPL sector in Aotearoa New Zealand

- 15 BNPL is currently offered by six lenders: Afterpay, Zip, Laybuy, Openpay, Genoapay (owned by Latitude Finance) and Klarna. A seventh lender, Humm, recently left the New Zealand market. Many have operations overseas. BNPL has grown rapidly in recent years, with a large spike in growth during the first COVID-19 lockdown.

BNPL is not currently covered by consumer credit laws

- 16 As BNPL does not charge consumers interest or fees (unless an instalment is missed) they are not defined as 'consumer credit contracts' under the CCCFA. BNPL lenders are therefore not required to adhere to most CCCFA obligations that apply to other lenders, including disclosure requirements, the responsible lending principles, affordability and suitability assessments, and certification of their directors and senior managers as 'fit and proper persons'.

Consultation to date

- 17 In November 2021, following Cabinet's approval [DEV-21-MIN-0218 refers], I released a discussion document *Buy-Now, Pay-Later: Understanding the Triggers of Financial Hardship*. The discussion document sought feedback on the benefits of BNPL, how BNPL could trigger financial hardship, and what options (both regulatory and non-regulatory) would balance the benefits of BNPL against these risks.
- 18 Submissions confirmed that BNPL brings benefits across the economy. However, submitters were divided about whether and how BNPL could create financial hardship. BNPL lenders submitted that any financial hardship primarily resulted from a change in a consumer's circumstances after entering into BNPL. Financial mentoring services, other lenders and community organisations submitted that it was a prior lack of affordability creating the risk of financial hardship.
- 19 Accordingly, submitters were divided over their preferred option to address potential financial hardship caused by BNPL, with BNPL lenders favouring an industry code, while banks, financial mentors and other organisations broadly supported the application of the CCCFA to the BNPL sector.
- 20 A number of submissions also highlighted the potential risk of financial and social hardship arising from BNPL being used to purchase alcohol. I consider that the

¹ Data provided by BNPL lenders for the year 2020-21.

proposals outlined in this paper will at least partially address these concerns where alcohol purchases may be unaffordable to the consumer.

Harm from BNPL

- 21 Evidence from overseas, submissions on the discussion document, and a survey conducted by MBIE indicate that the design and promotion of BNPL leads some consumers to enter BNPL contracts that they cannot afford to repay:
- 21.1 In an MBIE survey, 13 per cent of current BNPL users say that BNPL has caused them to delay payment of bills or forgo other essential expenditure, or that they have missed three or more repayments. Only 24 per cent of consumers who had difficulty with other expenses attributed them to a change in their circumstances.
 - 21.2 Financial mentors have reported that BNPL is significantly contributing to hardship faced by their clients. One financial mentor reported that there had been significant growth in the number of its clients having BNPL debt (from 2 per cent in 2019 to 17 per cent in 2021). While this does not necessarily mean that BNPL caused the hardship faced by these clients, 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.
 - 21.3 Credit reporting data provides comprehensive information about payment arrears (late or missed payments), 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 suggests that as at the end of May 2022, 8.4 per cent of active BNPL customers were in arrears. In comparison, around 8.6 per cent of personal loans and 4.1 per cent of credit cards were in arrears.
- 22 A number of BNPL features enable or worsen the lack of affordability:
- 22.1 Automatic increasing of credit limits worsens issues of affordability. 28 per cent of survey respondents who stated they delayed or missed essentials or bills, stated they did so because their credit limits were increased beyond what they could afford.
 - 22.2 Multiple providers sitting outside the credit system makes it easy to have multiple BNPL loans at once. FinCap provided evidence that for clients of financial mentors in 2022, 15 per cent of people with BNPL debts had three or more BNPL loans.
 - 22.3 BNPL's payment model can hide the true cost of borrowing. 30 per cent of respondents who had delayed or missed essentials or bills, said they had focused on the first instalment rather than the cost.
 - 22.4 Hardship may be further worsened 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. Christians Against Poverty, a financial mentoring

service, noted that several of its clients had had their debts passed on to collection agencies when they missed instalments.

Proposal for BNPL to be declared as a consumer credit contract under the CCCFA

Declaring BNPL as a consumer credit contract ensures consumers are protected as the sector evolves further

- 23 I recognise the BNPL sector has made progress on addressing the triggers and impacts of financial hardship, including by allowing flexibility in the timing of instalments which helps to minimise late fees, and many lenders having comprehensive hardship policies.
- 24 However, having considered the submissions, I propose to apply the CCCFA in a proportionate way to standardise practice and strengthen consumer protections, without losing the benefits of BNPL. A key issue, discussed below, is when to require BNPL lenders to assess affordability.
- 25 In addition to affordability requirements, the CCCFA has several provisions which would help to address the triggers of financial hardship caused by BNPL:
- 25.1 The CCCFA's disclosure rules (sections 17 – 26B) require lenders to inform users upfront of the initial unpaid balance, total credit limits, default, and other fees. Making consumers more aware of the nature of BNPL as a form of credit may influence consumer behaviour and makes BNPL more consistent with other credit products. In addition to this, the Credit Contracts and Consumer Finance Regulations 2004 (4AAAQ to 4AAB) require that, where payment amounts are advertised, the total amounts and number of payments are prominently stated.
- 25.2 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.
- 25.3 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.
- 25.4 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— (i) when breaches of the agreement have occurred or may occur or when other problems arise.

- 26 In addition, Chapter 12 of the Responsible Lending Code contains detailed guidance for lenders about how they should treat borrowers where repayment difficulties or other problems arise.
- 27 Declaring BNPL to be to be a consumer credit contract will mean that consumers can have confidence that in the event of a dispute with any BNPL lender, there is a dispute resolution service available to them.
- 28 I consider the CCCFA provisions outlined above will be challenging for the sector as it standardises processes across the sector, but should be workable (potentially with some modifications).

The most complex trigger of financial hardship to address is ensuring BNPL is affordable at the time the contract is entered into

- 29 Section 9C(3)(a)(ii) of the CCCFA imposes a general obligation that requires lenders to make reasonable inquiries to be satisfied that the borrower will likely make payments without substantial hardship. This affordability assessment obligation is the most effective way to address financial hardship from BNPL. However, it is also the most challenging for the sector under current business models.
- 30 Difficulties associated with applying affordability assessment obligations to BNPL are two-fold:
- 30.1 The cost of carrying out affordability assessments is relatively high compared with the small size of BNPL loans, and it will be difficult for BNPL lenders to recover that cost without charging interest or credit fees.
- 30.2 The time required to undertake an affordability assessment could be a barrier to consumers entering into BNPL. BNPL credit assessments are currently performed rapidly at point-of-sale based on readily accessible information about the consumer and transaction, and in some cases after obtaining a credit report. Adding substantial friction to BNPL is likely to greatly reduce the number of transactions processed, and to make it much more difficult for BNPL lenders to recover fixed costs.
- 31 Applying the CCCFA's prescribed affordability assessments to all BNPL is likely to make it unviable as a low-cost alternative to other credit products, and force BNPL lenders to either exit the market or migrate their services to larger, higher cost, longer term transactions. This would effectively remove the benefits of BNPL to consumers and potentially leave them worse off.
- 32 Some of the difficulty of applying affordability assessments to BNPL will be lessened in future as open banking further develops, and especially once a Consumer Data Right is operational. This would enable consumers to share more detailed information about their income and expenses directly from banks to BNPL providers. In the meantime, I consider it appropriate to strike a balance between addressing affordability with the challenges of conducting affordability assessments.

Affordability requirements will apply above a threshold, with alternative requirements below the threshold

- 33 I propose to exempt BNPL with a credit amount under a certain threshold from the requirement to conduct an affordability assessment in accordance with section 9C(3)(a)(ii) of the CCCFA.
- 34 Having considered the average size of BNPL loans, the ability for borrowers to service BNPL loans, and the revenue generated by BNPL providers I consider that a threshold of \$600 would be appropriate as a way to balance any impacts on access to low-cost credit with reductions in financial hardship.
- 35 However, I propose to undertake further consultation on draft regulations on the exact value of where to set the threshold. This is to ensure we strike the right balance between the competing objectives of protecting consumers and enabling safe and affordable credit.
- 36 A condition of the exemption would be a requirement to obtain information from a credit reporting agency, including information about open accounts and repayment history. BNPL lenders would also have to report information on open accounts, payment history and defaults back to the credit reporting agency.
- 37 I recognise that credit reports are not a substitute for affordability assessments as they consider a consumer's ability to re-pay credit (backward looking) rather than ability to afford a BNPL arrangement (forward looking). I am also aware that multiple requests for a credit report may leave a minor negative footprint on a consumer's profile. However, credit reporting will aid identification of borrowers at higher risk of hardship, and will also mean that other lenders, including other BNPL lenders, are aware of the BNPL contracts that a consumer has, and whether they are in arrears with any BNPL lender.

I propose to consult on which form of affordability assessments apply above the threshold

- 38 Above the threshold, I believe that some form of affordability assessment should be required. I propose to consult on two options during the development of the regulations, as there is still some uncertainty as to the impact of affordability assessments on the BNPL business model.
- 39 Option one is to require BNPL lenders to conduct a full, detailed affordability assessment in accordance with the requirements in Regulations 4AC-4AN of the CCCFA. These regulations set out prescriptive requirements for considering affordability (including making reasonable enquiries into and verifying the borrower's likely income and relevant expenses).
- 40 Option two is to require BNPL lenders to assess affordability against the more general requirements in section 9C(3)(a)(ii) of CCCFA legislation but not the more prescriptive requirements in Regulations 4AC-4AN. Lenders would still be required to collect information from borrowers to be satisfied they could make repayments without suffering substantial hardship, however there would be more flexibility in how they meet these requirements.

- 41 When considering feedback on these options I will consider aim to strike a balance between protecting consumers from borrowing sums they are unable to repay, while ensuring those same borrowers can access credit via BNPL.

CCCFA disclosure requirements can be adjusted to better fit with BNPL

- 42 To address additional triggers of financial hardship which may not be sufficiently covered by the provisions in the CCCFA, I am also seeking agreement to introduce additional disclosure obligations as a condition of any exemptions provided to BNPL lenders. This will require default fees (for missed or late instalments) and the timing of instalments to be made clear to the consumer at the point of each purchase using BNPL. Currently, some BNPL lenders only provide this information when the consumer first signs up, or some information may not be given at all. This condition will ensure that this information is clear to all consumers using BNPL.

Next steps and implementation

- 43 The above policy would be implemented through regulations made under the CCCFA. These would both declare BNPL contract to be a consumer credit contract and provide an exemption for BNPL under a threshold credit amount.
- 44 I intend to:
- 44.1 release a public exposure draft of regulations and seek feedback on whether any changes are necessary to guidance contained in the Responsible Lending Code in December 2022;
 - 44.2 consult with stakeholders on the detail and exact dollar value of the threshold in the regulations
 - 44.3 consult with stakeholders on the form affordability assessments take over the threshold; and
 - 44.4 report back to Cabinet on the outcome of this consultation and bring final regulations to the Cabinet Legislation Committee for approval by the second quarter of 2023.
- 45 Following the commencement of regulations, it is important they are reviewed to ensure they are achieving the policy objectives and remain appropriate in light of market developments. As discussed above, open banking will further assist with this once it is developed. For this reason, I propose to review the regulations 12 months after they are in force.

Financial Implications

- 46 Initial advice from the Commerce Commission, which enforces the CCCFA, suggests there are likely to be some minor financial implications from declaring BNPL to be a consumer credit contract. Any costs will be absorbed within current appropriations.

Legislative Implications

- 47 The proposals in this paper will be implemented through regulations under the CCCFA.

Impact Analysis

Regulatory Impact Statement

- 48 The impact analysis requirements apply to the proposals in this paper. An impact summary has been prepared and is attached.
- 49 MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached 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.

Climate Implications of Policy Assessment

- 50 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as there is no direct impact on emissions.

Population Implications

- 51 Submissions on the discussion document and responses to the accompanying survey suggest that the typical users of BNPL are women, people under 45, and individuals who are unable to access traditional credit products.
- 52 Survey responses suggested those who suffered financial hardship were more likely to be Māori (15 per cent as opposed to 10 per cent of New Zealand Europeans). While there may be a reduction in access to BNPL from applying the CCCFA, doing so proportionately will mean those reductions are minimised. At the same time, Māori will be better protected from financial hardship.

Human Rights

- 53 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 54 The following agencies have been consulted on this Cabinet paper: the Treasury, the Department of Prime Minister and Cabinet, the Commerce Commission, and the Financial Markets Authority. My officials have also consulted industry stakeholders and financial mentoring organisations, who have provided data and insights into the sector.

Communications

55 I will be announcing Cabinet decisions through a press release.

Proactive Release

56 I intend to proactively release a copy of this paper in whole within 30 business days of decisions being confirmed by Cabinet.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 note that Buy-Now, Pay-Later (BNPL) is not currently subject to the consumer protections in the Credit Contracts and Consumer Finance Act 2003 (CCCFA);
- 2 agree that BNPL contracts be declared to be consumer credit contracts under the CCCFA;
- 3 agree that BNPL with credit amounts below a threshold be exempt from requirements to assess affordability under the CCCFA on the conditions that:
 - 3.1 creditors instead obtain comprehensive credit reporting information; and
 - 3.2 creditors provide comprehensive credit reporting information back into the credit reporting system;
- 4 agree to consult on a threshold of \$600;
- 5 agree that affordability assessments be required for BNPL with credit amounts above the threshold and that consultation occur on two options:
 - 5.1 affordability assessments in accordance with the process prescribed in the Credit Contracts and Consumer Finance Regulations 2004; or
 - 5.2 affordability assessments in accordance with the CCCFA's principles-based requirement to make reasonable inquiries into the affordability of a loan, but not the process prescribed in the Credit Contracts and Consumer Finance Regulations;
- 6 agree that as a condition of any exemption, default fees (for missed or late instalments) and the timing of instalments must be made clear to the consumer at the point of each purchase using BNPL;
- 7 agree to give effect to the above proposals through regulations under the CCCFA;
- 8 authorise the Minister of Commerce and Consumer Affairs to approve and release an exposure draft of the regulations for public feedback;
- 9 authorise the Minister of Commerce and Consumer Affairs to make additional policy decisions and minor or technical changes to the policy decisions in this paper,

I N C O N F I D E N C E

consistent with the general policy intent, on issues that arise in drafting of the regulations;

- 10 invite the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs