

Regulatory Impact Statement Addendum: Buy Now, Pay Later Regulations

Coversheet

Purpose of Document	
Decision sought:	Proposed reforms to the Credit Contracts and Consumer Finance (Buy Now, Pay Later) Amendment Regulations 2023.
Advising agencies:	Ministry of Business, Innovation and Employment (MBIE)
Proposing Ministers:	Minister of Commerce and Consumer Affairs
Date finalised:	14 August 2024
Problem Definition	
<p>The Credit Contracts and Consumer Finance Act 2003 (CCCFA) limits default fees to reasonable amounts directly related to the costs and losses incurred by the provider due to the default. These provisions were designed for traditional credit products that can recover those costs and losses through interest charges. However, buy now pay later (BNPL) is an interest-free credit product, and the viability of this product relies on merchant fees and default fees.</p> <p>BNPL providers believe that complying with these fee restrictions would restrict how they calculate and charge fees. Protect Commercial Interests</p>	
Executive Summary	
<p>This regulatory impact statement is an addendum to the Regulatory Impact Assessment (RIA) <i>Applying the Credit Contracts and Consumer Finance Act in a proportionate way to buy now pay later lenders</i>, released in July 2023.</p> <p>The purpose of this addendum is to investigate potential options identified to address concerns raised by BNPL providers regarding compliance with the CCCFA fee provisions.</p> <p>This addendum examines five proposals:</p> <ul style="list-style-type: none">• Option one – counterfactual option: BNPL providers will need to comply with the CCCFA fee provisions by 2 September 2024• Option two – time-limited exemption from the CCCFA fee provisions• Option three – exemption from the CCCFA fee provisions conditional on compliance with a default fee cap• Option four – exemption from the CCCFA fee provisions conditional on compliance with a reasonable cross-subsidisation of total credit losses through default fees• Option five – exemption from the CCCFA fee provisions.	

We have conducted a targeted consultation on potential reforms and analysed them against criteria reflecting government objectives, and the purposes of the CCCFA.

Based on the analysis presented in this regulatory impact statement, our preferred option is option four (exemption from the CCCFA fee provision under conditions).

We propose to monitor the outcomes of any reform implemented and compare their actual impacts with those presented in this regulatory impact statement after one year of their commencement.

Limitations and Constraints on Analysis

To diagnose the problem and estimate the potential impacts of our options, we have mainly used qualitative evidence from the submissions available to us. Due to the limited amount of time we had, we consulted with key stakeholders, 29 in total, with nine of them providing feedback. This limited the number and variety of feedback we could have received from a larger group of stakeholders. This targeted consultation was also conducted within one week which would have likely limited the amount and depth of feedback of stakeholders. However, we were able to follow up with some of them to ask further questions to fill the analysis gap.

One of the government's objectives in regulating BNPL is to reduce the risk of financial hardship caused by this type of credit. However, the relationship between BNPL and financial hardship is complex. In theory, it could cause, exacerbate, or be a symptom of financial hardship. While we have data indicative of financial hardship, it is difficult to determine whether instances of hardship among BNPL borrowers ultimately result from default fees charged by BNPL, or from other factors (such as unaffordable BNPL loans, other credit products, existing overspending behaviour, existing poverty).

Responsible Manager(s) (completed by relevant manager)

Sally Whineray Groom
Acting Manager
Consumer Policy
Ministry of Business, Innovation and Employment

14 August 2024

Quality Assurance (completed by QA panel)

Reviewing Agency:	MBIE's Regulatory Impact Analysis Review Panel
Panel Assessment & Comment:	An internal quality assurance panel convened by MBIE has reviewed the Regulatory Impact Statement (RIS) and considers that the information and analysis it contains meets the quality assurance criteria 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?

BNPL is an innovative form of short-term, unsecured credit that costs consumers nothing if they make repayments on time

1. BNPL allows consumers to spread out payments to streamline their cash flow and purchase items without incurring fees if they make their repayments on time. BNPL is gaining significant traction in New Zealand, with a demand increasing by 11.1% year-on-year.¹ Confidentiality
2. Like credit cards, BNPL is effectively a payment option available to consumers who want to make a particular purchase (eg online) from participating merchants. They can make these purchases within credit limits set by the BNPL provider (usually between \$1000 and \$2000), which are like credit card limits.
3. BNPL is an innovative credit product that has been highly successful since it entered the market, disrupting more traditional forms of credit. It appears to have displaced some lending (eg reduced demand for higher-cost short-term, small-amount loans) and competes most directly with credit card products. Market power between BNPL providers is now more concentrated than when the 2023 RIS was finalised and since BNPL entered New Zealand, with only three providers still active in New Zealand. Recent changes in economic conditions appear to have rewarded those with more scale and/or efficient business models, and network effects may also have contributed to this consolidation (as consumers gradually settle on BNPL products that are more commonly available through merchants).

Most revenue for BNPL providers comes from merchant service fees, with a small portion coming from consumers in the form of default fees

4. BNPL outcompetes most credit cards on price, by relying for most of their revenue on a fee charged to the merchant (usually a percentage of the transaction value or a fixed fee). BNPL providers accept the credit risk by paying the retail price of the consumer's purchase upfront to the merchant and then collect payments from the consumer in instalments.
5. The merchant pays a fee to the BNPL provider. Merchants are generally compensated for these fees because BNPL is very attractive to consumers and tends to increase sales. In 2023, one BNPL provider contributed to a \$9.6 billion increase in sales for its Australian merchant partners³.
6. If a consumer is late or misses an instalment, the BNPL provider may charge a fee, which can be a flat fee (eg \$10 for a missed instalment) or a percentage of the transaction value. All BNPL providers currently voluntarily cap their default fees (at different levels).

¹ Centrix, Credit Insights Report, July 2024

Protect Commercial Interests

³ Mandala, Afterpay's Economic Impact in Australia, June 2024.

BNPL provider	Default fees structure
Afterpay	<ul style="list-style-type: none"> for orders below \$40, the total late fees are capped at 25% of the original order value; for orders of \$40 or above, the total late fees are capped at 25% of the original order value up to a maximum of \$68.
Klarna	<ul style="list-style-type: none"> Default fees range from \$0 to a maximum of \$24 depending on the size of the purchase.
ZIP	<ul style="list-style-type: none"> Default fees are capped at \$40 per order.

- Because the BNPL average transaction value is relatively small compared to other non-BNPL loans Confidentiality BNPL providers tend to invest relatively little in pursuing unpaid debts.
- Centrix data⁴ suggests that in June 2024, 8.3% of active BNPL customers were in arrears (late or missed payments), the lowest level since November 2023. In comparison, around 5.6% of vehicle loans, 4.1% of credit cards, and 8.6% of personal loans were in arrears in June 2024. BNPL borrowers are more likely than others to be in arrears for more than 90 days (6.7% of BNPL accounts in arrears have been in default for at least 90 days, 0.2% for 60 to 89 days, 0.3% for 30 to 59 days, and 1.1% for 1 to 29 days).
- Confidentiality

In 2022, the Government decided to apply the CCCFA to BNPL providers to provide protection for consumers with some exemptions to ensure BNPL products remain viable

- As stated in the 2023 RIA, BNPL credit was not covered by existing consumer credit laws, because BNPL providers do not charge consumers interest or fees unless an instalment is missed. This means that they are currently not a 'consumer credit contract' for the purposes of the CCCFA, and therefore not subject to the obligations that apply to other forms of consumer credit (but will be as of 2 September 2024).
- As noted above, BNPL arrangements are a convenient low-cost alternative to traditional consumer credit products. However, BNPL could also cause, worsen, or be a symptom of financial hardship. In the short, targeted consultation we conducted in July-August 2024, financial mentors reported that BNPL debts are becoming more common among clients struggling with financial hardship and debt.
- The Government was concerned that BNPL could create or exacerbate financial hardship, and in 2022 it decided to apply the CCCFA to BNPL providers, with certain exemptions. The exemptions were intended to ensure BNPL business models will remain workable while ensuring that consumers using this form of credit will receive many of the same protections as borrowers in other consumer credit contracts.

⁴ Centrix, Credit Insights Report, July 2024

BNPL Regulations will take effect on 2 September 2024

13. The BNPL Regulations, which were finalised in August 2023 and will take effect on 2 September 2024, set out how the CCCFA requirements are adjusted to apply to BNPL providers. The delayed start date was implemented to allow BNPL providers to comply with the regulations on time.

Main CCCFA obligations that will apply to BNPL providers	CCCFA obligations that will apply differently to BNPL to ensure they are workable
<ul style="list-style-type: none"> • Complying with most of the responsible lending practices, including assisting borrowers to make informed decisions, and treating them reasonably and ethically. • Being part of an external dispute resolution scheme and providing relief to borrowers in case of financial hardship. • Various disclosure requirements. • Directors and senior managers will need to be certified by the Commerce Commission and comply with their due diligence duties. • Setting reasonable fees. 	<ul style="list-style-type: none"> • BNPL loans will be exempt from the requirement to carry out affordability assessments if they comply with a range of credit reporting and other requirements intended to reduce the risk of consumers getting into problem debt. • The requirement to disclose the borrower’s right to cancel the contract will be modified to reflect the cancellation policies of BNPL loans. • Inquiries into the suitability of the loan for the consumer will not be required.

14. This addendum has been developed to address concerns raised by a BNPL provider regarding the CCCFA fee provisions (sections 41 and 44A of the CCCFA).

15. The following sections outline the policy rationale behind these sections and the reasons for their inclusion in the 2023 regulations.

BNPL providers will be subject to the CCCFA reasonable fee provisions

16. Two of the provisions under *Subpart 6 – Fees* of the CCCFA would apply to BNPL providers. Other sections under this subpart are irrelevant to BNPL because they do not charge any other fee than default fees.

17. These two provisions are:

- a. Section 41 which states that a consumer credit contract must not provide for a credit fee or a default fee that is unreasonable.
- b. Section 44A which states that to determine 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 creditor of the following:
 - i. Any cost incurred by the creditor.
 - ii. A reasonable estimate of any loss incurred by the creditor as a result of the debtor’s acts or omissions.
 - iii. The court must also consider reasonable standards of commercial practices when determining whether the fee reasonably compensates the creditor.

The CCCFA fee provisions were put in place to prevent manipulation of interest rates and fees

18. The *Credit Contracts Act 1981* required the disclosure of an “annual finance rate” (**AFR**), a single rate that included both fees and interest. However, the AFR was found to be ambiguous and of limited help to consumers in understanding the cost of credit. As a result, the CCCFA repealed the Credit Contracts Act and the AFR in 2003.
19. The AFR was replaced with requirements for disclosing annual interest rates and the dollar value of credit fees. This change aimed to provide borrowers with a clearer breakdown of fees and interests applicable to a loan, allowing them to objectively assess the suitability of different loan offerings. The premise is that credit offered at lower interest rates is likely to be more attractive to consumers.
20. To prevent manipulation of interest rates and fees, the CCCFA also provides that fees cannot be unreasonable (section 41). This principle was established to prevent creditors from luring customers with low interest rates while imposing high fees that essentially function as interest charges, of which consumers may not be aware until after signing up.
21. Subsequently, the *Credit Contracts and Financial Services Law Reform Act 2014* amended the CCCFA and separated default fees and other credit fee provisions into distinct sections to address potential confusion between the two types of fees (section 44 credit fees and section 44A default fees).

Under these provisions, default fees should only cover costs and losses that are closely related to the particular borrower’s default

22. Default fees are often a source of problems for consumers, and are quite different from other credit fees, as these fees are often the ones that consumers expect not to incur, and in addition may be difficult to see upfront.
23. The CCCFA requires costs and estimated losses to relate directly to the matter giving rise to the fee – either of the matters related to the credit fee, or costs related to a breach or enforcement for a default fee. The policy intention is that lenders’ costs of capital and profits are built into the interest rate.
24. The High Court, in *Commerce Commission v Sportzone Motorcycles and Motor Trade Finance*⁵, agreed that certain establishment fees, account maintenance fees and default fees were unreasonable because there was not a sufficient connection between the actual transactions and the costs being recovered through the fees. The creditor was recovering general costs through its fees, and the High Court held that indirect and fixed costs should be recovered through interest rather than fees under the CCCFA. The Court also stated that there was no reason why temporary defaulters should pay costs attributable to other debtors who default, therefore prohibiting cross-subsidisation of costs and losses.
25. Under the CCCFA fee provisions, and following the above-mentioned judicial guidance, lenders must take a transaction-specific approach to the setting of fees. Default fees should only cover costs and losses that are closely related to the particular borrower’s default.

⁵ Supreme Court Judgement, Sportzone Motorcycles Limited and Commerce Commission, 2016

In 2022, the Government decided to apply the CCCFA fee provisions to BNPL to address concerns raised by financial mentors about the accumulation of BNPL default fees

26. Between November 2021 and December 2022, we conducted two rounds of consultation to gather feedback on the potential for BNPL loans to cause financial hardship for consumers, as well as on the proposed regulations.
27. During these consultations, financial mentoring organisations highlighted that they were noticing a growing number of clients for whom BNPL payments were becoming a significant part of their debt. These organisations indicated that consumers may face financial hardship from the use of BNPL in two main ways:
 - c. When a consumer is unable to make their BNPL repayment instalments, leading to compounding hardship through the application of missed or late payment fees.
 - d. When a consumer makes BNPL payments but, in doing so, is unable to afford essential goods and services or meet other debt repayment obligations. For example, some consumers use credit cards to pay their BNPL instalments, as mentioned by BNPL providers.
28. Financial mentors also raised concerns about the accumulation of default fees (as they can stack up for customers with multiple active transactions), which can appear high when expressed in annualised terms—eg 25% of the purchase price in fees accumulated over two months is roughly equivalent to 150% in interest per annum.
29. As a result of these concerns, Cabinet agreed in 2022 to apply sections 41 and 44A of the CCCFA to BNPL providers to limit the impact of late fees on exacerbating financial hardship.
30. Compliance with the CCCFA fee provisions means that general operating costs (including costs of unpaid debt) would need to be fully covered by merchant fees, as cost cross-subsidisation is prohibited under the CCCFA. This would indirectly impact consumers, as these fees affect the merchant's profits and, consequently, the retail prices they need to charge consumers.

A BNPL provider has raised concerns with the CCCFA default fee provisions

31. BNPL providers have generally expressed confidence they will be in a position to comply with the relevant obligations in the CCCFA by 2 September 2024.
32. However, in the last two months, concerns have been raised about complying with the CCCFA default fee provisions, in particular the requirement that default fees can only cover costs and losses that are closely related to the particular borrower's default.
33. This requirement prevents BNPL providers from cross subsidising the costs between different categories of borrowers (those who do not repay their debts and default fees and those who pay their default fees).
34.

Protect Commercial Interests
35. To the extent BNPL providers are charging borrowers for other costs through their default fees, the adjustment required by the current CCCFA policy would be to increase the merchant fees BNPL

providers charge, to make up for the losses incurred by lower default fees. Protect Commercial Interests

[Redacted]

36. Protect Commercial Interests

[Redacted]

37. Protect Commercial Interests

[Redacted]

What is the policy problem?

The CCCFA fee provisions could create a competitive disadvantage for BNPL products

38. The BNPL Regulations, due to come into force on 2 September, were intended to ensure BNPL business models will remain workable while ensuring that consumers using this form of credit will receive many of the same protections as borrowers in other consumer credit contracts.

39. As the BNPL business model is different from more traditional lenders, this RIS questions whether the CCCFA fee provisions should apply to this credit product in the same way they apply to consumer credit lenders, as these provisions were originally drafted for credit products charging interest, as well as fees.

The unintended impacts of the application of the CCCFA default fees provisions could reduce access for consumers to BNPL

40. The rationale for the application of the CCCFA default fees provision was to address concerns raised by financial mentors about the accumulation of BNPL default fees, not to reduce or constrain the availability of BNPL products for consumers.

41. If a BNPL provider leaves the market, this would impact its customers, who will then need to sign up (if they have not already) with one of the remaining two BNPL providers to access BNPL loans.

42. Since BNPL providers do not have agreements with the same merchants, the products and services consumers would be able to access via BNPL are likely to change. However, customers are unlikely to be impacted in other ways.

43. If BNPL business models are no longer viable under the CCCFA fee provisions, they might all exit the market. This would either restrict access to short-term and small-amount loans to New Zealanders or make these loans more expensive, where the borrower moves to an interest-charging product (e.g. credit card, short-term personal loan).

What objectives are sought in relation to the policy problem?

44. The objectives in relation to the policy problem are the same as those used to develop the current policy applying to BNPL. As stated in the 2023 RIA, 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?

45. The criteria we will apply to assess the options are:

- e. Adequate consumer protection
- f. Compliance costs remain proportionate
- g. Promotes fair markets for credit.

46. The above criteria have been updated from the 2023 RIA to better reflect the specific policy problem that we are seeking to address. As noted above, the overall policy objectives remain the same as in the RIA 2023 and the updated criteria aim to strike a balance between ensuring adequate consumer protection under the CCCFA and maintaining the viability and competitiveness of BNPL products as a low-cost alternative to traditional credit.

47. The first criterion (adequate consumer protection) builds on the first criterion in the 2023 RIA (ensuring the reduction of financial hardship) but has been updated to reflect the specific problem this RIS Addendum seeks to address. In the 2023 RIA, the problem discussed was whether and how to bring BNPL under the CCCFA to reduce the risk of financial hardship. In this RIS Addendum, the specific problem discussed is whether and how responsible fees provisions should apply to BNPL products.

48. The second criterion (compliance costs remain proportionate) is approached the same way as in the 2023 RIA. It reflects the costs incurred by BNPL providers in complying with the CCCFA fee provisions and the certainty of the requirements for both BNPL providers and regulators.

49. Regarding the third criterion (promotes fair markets for credit), the concept of 'fair' markets for credit is recognised in the purposes of the CCCFA. Fairness is a subjective term, but we interpret it as providing a competitive market for BNPL providers and consumer credit lenders, and a range of credit products for consumers to choose from.

50. We are weighing each criterion equally.

What options are being considered?

51. Following the consideration of BNPL providers' concerns, we consider the following options:

- a. Option One: Counterfactual: BNPL providers will need to comply with the CCCFA fee provisions by 2 September 2024
- b. Option Two: Time-limited exemption from the CCCFA fee provisions
- c. Option Three: Exemption from the CCCFA fee provisions conditional on compliance with a default fee cap
- d. Option Four: Exemption from the CCCFA fee provisions conditional on compliance with a reasonable cross-subsidisation of total credit losses through default fees
- e. Option Five: Exemption from the CCCFA fee provisions.

52. Option Two would provide temporary relief for BNPL providers until they can adjust their contractual arrangements with merchants and merchant fees if needed.
53. Options Three, Four, and Five would exempt BNPL providers from the CCCFA fee provisions, while still ensuring there are some protections against excessive default fees (either by a way of condition or by other CCCFA provisions still applying to BNPL providers). We note that if one of these options is pursued, this would be the first time an exemption from the reasonable fee provisions would be granted for an alternative business model.

Option One – Counterfactual: compliance with the CCCFA fee provisions by 2 September 2024

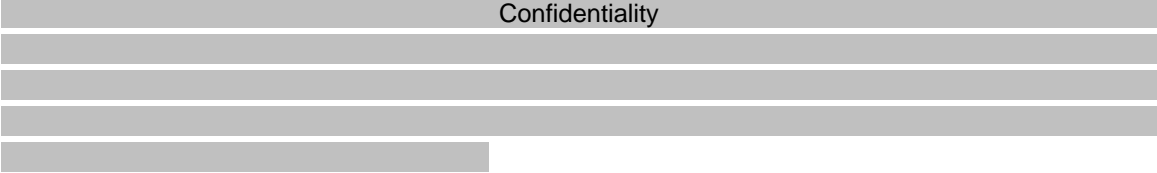
54. Under the counterfactual option, BNPL providers will need to comply with the CCCFA provisions by 2 September 2024. They would therefore need to comply with sections 41 and 44A of the CCCFA and ensure their default fees are reasonable for the purposes of the CCCFA and do not compensate the lender for more/anything else than the cost and loss they incur as a result of the borrower’s late payment(s).

55. **Protect Commercial Interests**

Criteria	Assessment
Adequate consumer protection	This option will reduce the risk of financial hardship from accumulated BNPL default fees. The cause of financial hardship is difficult to attribute to default fees charged by BNPL providers. Default fees can however worsen the financial hardship experienced by borrowers who default, as they increase the amount owed. Financial mentors have observed that some clients who miss several BNPL instalments for different orders accumulate default fees. This can lead them to forgo essential needs to repay their BNPL loans, as access to BNPL products is considered a “lifeline” for emergency credit for these clients.
Compliance costs	This option will impose new and higher compliance costs for BNPL providers. BNPL providers will need to ensure their fee structure complies with the CCCFA. If not, they will need to make the necessary adjustments by lowering the default fees they charge, which would result in revenue losses that will not be able to be recouped through merchant fees that cannot be immediately adjusted.
Fair markets for credit	This option would affect BNPL providers’ commercial viability, as their profitability and revenue would be more heavily reliant on merchant fees than default fees. Where BNPL providers need to increase merchant fees (to offset the loss incurred by lower default fees) in a way that outweighs the benefits merchants receive from BNPL, merchants might decide to end or refuse BNPL agreements, making the BNPL market less efficient and less competitive.
	Protect Commercial Interests BNPL providers exiting the market could result

	<p>in further concentration in the BNPL market and less competition in the consumer credit market overall. This would reduce consumers' choice of BNPL products and lead them to opt for potentially more expensive interest-charging credit product.</p>
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Stakeholder views⁶

56. BNPL providers expressed concerns that applying the CCCFA fee provisions will constrain their approach to calculating and charging default fees, making it more difficult to maintain a commercially viable business model.
57.  Confidentiality
58. An industry body with BNPL providers among its members believes that the CCCFA fee provisions are too stringent for consumer credit providers in general. It believed that compliance costs would be disproportionate to the low-risk nature of BNPL products and would put them at a disadvantage.
59. A financial mentor network (which supported 69,000 whānau in 2023 in financial hardship from diverse causes) believes that exempting BNPL providers from the CCCFA fee provisions would negatively impact BNPL borrowers.
60. They referenced research⁷ showing that many BNPL users incur late penalties (one in six of the 705 surveyed BNPL users) and sacrifice essential spending to cover BNPL payments (one in five). They also reported that it is common for their clients to have multiple purchases financed through one BNPL provider (or several BNPL providers).
61. Overall, their view is that requiring BNPL providers to comply with the CCCFA, including conducting affordability and suitability checks, could improve outcomes for their clients, especially in so far as some financial mentors are unable to consolidate their clients' BNPL debts. However, they have expressed concern that increasing merchant fees by BNPL providers could inflate prices for all consumers.
62. A consumer advocate mentioned that the account freeze policy on default by BNPL providers is an effective deterrent for non-payment and stated that unreasonable default fees should not be used to deter borrowers from defaulting.
63. Banks, which provide the vast majority of consumer lending in New Zealand, advocate for equal consumer protection under the CCCFA, with one mentioning that among its customers, those using BNPL are two to three times more likely to be late on payments or face financial difficulties.

⁶ Collected as part of a one-week targeted consultation.

⁷ Aaron Gilbert, Ayesha Scott, Problem debt, over-indebtedness, and BNPL: the case of young adults in New Zealand, 2023

64. The Commerce Commission mentioned that it is only under this option that competitive neutrality will be safeguarded. However, it also suggested that competition could be negatively impacted if one or more BNPL providers decide to exit the market due to fee provisions.

Option Two – Time-limited exemption from the CCCFA fee provisions

65. Under this option, BNPL providers would be given additional time (for example two years) to comply with the CCCFA fee provisions. During this period, BNPL providers will be able to adjust their default fees as well as the fees they charge merchants, if necessary.

66. This option would allow BNPL providers to adhere to CCCFA fee provisions without incurring financial losses by charging more to merchants.

67. However, it will only offer temporary relief, as BNPL providers would eventually need to comply with the CCCFA default fees after the exemption expires.

Criteria	Assessment
Adequate consumer protection	This option would delay protections from unreasonable default fees for a period of time. After this period, BNPL providers will have to comply with the CCCFA fee provisions, ensuring the same level of protection as under the counterfactual option.
Compliance costs	<p>This option would enable BNPL providers to transition to compliance while incurring fewer losses than the counterfactual option as they will have time to adjust the merchant fees they charge. It is however unclear whether BNPL providers would be able to increase merchant fees by the same amount they lose because of lower default fees, especially since competitive pressure is driving merchant fees lower.</p> <p>Legal obligations will be as clear as the counterfactual option, as it would only postpone the date by which BNPL providers will need to comply with the CCCFA fee provisions.</p>
Fair markets for credit	<p>Under this option BNPL providers will be given additional time to comply with the CCCFA fee provisions, reducing the risk of them exiting the market and improving their ability to operate at a profit. However, as for the counterfactual option, they will be at a commercial disadvantage when they will have to comply with the CCCFA fee provisions, as they will need to more heavily rely on merchants’ fees to ensure their profitability.</p> <p>They will have the time to, if necessary, increase merchant fees to offset the potential losses incurred from lower default fees. As per the counterfactual option and depending on the extent BNPL providers decide to increase merchant fees, participating merchants might decide to end/refuse BNPL agreements, negatively impacting the BNPL market, and therefore the competition in this market and consumers’ choice for credit products.</p>

Stakeholder views

Criteria	Assessment
Adequate consumer protection	The default fee cap will ensure BNPL providers do not charge excessive default fees. This will protect consumers in a similar way as the CCCFA fee provisions, although not in all circumstances the level of protection provided by the cap will be as high as it would be under the counterfactual option.
Compliance costs	<p>All BNPL providers will incur compliance costs under this option.</p> <p>BNPL providers will need to make the necessary adjustments by lowering the default fees they charge, which would result in revenue losses that will not be able to be recouped through merchant fees that cannot be immediately adjusted Protect Commercial Interests</p> <p>This option would also ensure legal certainty to BNPL providers and the Commerce Commission as regulator.</p>
Fair markets for credit	<p>This option will standardise BNPL providers' fee structures, which could foster competition based on customer service and product offerings rather than default fees. It will also ensure that more proportional requirements apply to BNPL providers. However, different requirements will apply across the consumer credit market.</p> <p>Protect Commercial Interests</p> <p>this could lead to a further concentration in the BNPL market, limiting consumers' choice of BNPL products and small amounts, and short-term loans.</p> <p>As options one and two, under this option, BNPL providers might decide to increase merchant fees to compensate for the loss incurred by lower default fees. Depending on the extent of the increase in merchant fees, merchants might decide to end or refuse BNPL agreements, resulting in a less efficient and less competitive BNPL market.</p>

Stakeholder views

76. Protect Commercial Interests

77. A network of financial mentors suggested that capping default fees could help limit the risk of excessive fees and prevent debt spirals if set at a low rate. However, they also mentioned that the cap will need to be regularly reviewed to adapt to changes in the financial environment, such as increases in business expenses and changes in economic conditions. Additionally, it suggested that the cap should be related to the outstanding balance rather than the individual purchase to reduce the risk of bill shock from the application of multiple fees across small purchases within a balance. It suggested that a maximum daily charge cap could be set, drawing from the approach used for high-cost credit.

78. Banks and the Commerce Commission expressed concerns about the fairness of this option, as implementing different fee rules for different types of lenders would establish a precedent and raise competitive neutrality questions.

Option Four – Exemption from the CCCFA fee provisions conditional on compliance with a reasonable cross-subsidisation of total credit losses through default fees

79. This option would exempt BNPL from the CCCFA fee provisions with conditions that provide bespoke protections against excessive fees while permitting some cross subsidisation for default by other borrowers. The conditions would prevent BNPL providers from over-recovering total credit costs and losses incurred by defaulting borrowers through default fees.

80. This option, if pursued, will, however, go against the Supreme Court judgement⁸ stating that *“there is no compelling reason why temporary defaulters should pay costs attributable to other debtors who default permanently. Temporary defaulters, who can be charged fees covering the cost of their own defaults, have no greater responsibility to pay for the costs involved with permanent defaulters than any other debtors”*. However, this judgement was not made in the context of BNPL products specifically, and the provisions were not in force for BNPL providers at that time. There are currently no prior or active cases looking at default fees charged by BNPL providers.

Criteria	Assessment
Adequate consumer protection	This option provides protections against excessive default fees, by ensuring BNPL providers do not over-recover total credit costs and losses through default fees. However, the level of protection provided by this option will not be as high as it would be under the counterfactual option (as the level of default fees BNPL providers will be able to charge will be higher).
Compliance costs	<p>This option would enable BNPL providers to recover a certain amount of credit losses and costs incurred from defaulting borrowers. BNPL providers will have more flexibility in setting their default fees which would likely limit their compliance costs. Those that already cross-subsidise costs will need to ensure they comply with the “reasonableness” standard. We understand that BNPL providers are confident they are already complying with the conditions attached to this exemption, so we estimate the compliance costs to be low.</p> <p>This option might be less clear than other options, as new provisions will be enacted along with a different “reasonableness standard of cross-subsidisation”. Legal certainty and clarity will depend on how the provisions are drafted and then interpreted by the regulator and the courts.</p>
Fair markets for credit	Under this option, BNPL providers will not have to change their business model, since they will still be able to generate similar levels of revenue from merchant fees and default fees charged to borrowers who default. This option will ensure BNPL providers continue to operate at a profit and be able to compete with other small-amount short-term credit lenders,

⁸ Supreme Court Judgement, Sportzone Motorcycles Limited and Commerce Commission, 2016

	<p>thus providing consumers with a variety of credit products to choose from.</p> <p>However, it will lead to the application of different requirements across the consumer credit market.</p>
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Stakeholder views

81. BNPL providers believe that this option will address the identified problem and will ensure they can continue to offer consumer credit by providing more flexibility to calculate and charge default fees. They stated that the conditions attached to the exemption will ensure consumers are protected from excessive fees and that the CCCFA disclosure requirements will also ensure customers have a clear understanding of default fees that may be payable on BNPL products.

82.

Protect Commercial Interests

83. An industry body supports this option to ensure that BNPL products in New Zealand remain profitable and that consumers still have a viable option to use such products for their purchases.

84. A network of financial mentors does not believe that this option will improve the BNPL provider's viability projections, as the changes will not be effective by 2 September 2024. According to this stakeholder, any relaxation of the CCCFA fee provisions for BNPL could raise fairness issues, especially when default fees are applied on an average rather than on a transaction basis. It also mentioned that the potential to charge higher default fees could expose borrowers facing hardship to even greater financial difficulties, stress, and increased poverty and material hardship. It also suggested that if an exemption is granted, it should be limited to the default fee provisions of the CCCFA and not the requirement to charge reasonable fees.

85. Another financial mentoring organisation mentioned that allowing cross-subsidisation would create a perverse incentive for BNPL providers not to make efforts to recover debts, to keep default costs and thus fees, high.

86. As for option two, one bank suggested that any relief provided to BNPL providers should also be extended to other lenders to avoid creating an unfair market advantage. Another bank mentioned that having borrowers pay for others' defaults is unfair.

87. The Commerce Commission stated that if an exemption is granted, other fee-based business models may also seek a similar exemption (for instance, interest-free credit card products are currently available in Australia). The regulator questions to what extent the proposed exemption and attendant conditions would impose a meaningful restriction on the level of default fees that could be charged by a BNPL provider. It mentioned other restrictions on default fees which could become relevant from an enforcement perspective (CCCFA oppression provisions, unfair contract terms provisions in the *Fair-Trading Act 1986*, and the common law rule against penalties). To assist with regulatory enforcement, the regulator suggested that any regulatory changes should ensure that BNPL providers are required to keep (and review) records on how they have calculated the default fees.

Option Five– Exemption from the CCCFA fee provisions

88. This option would exempt BNPL from the CCCFA fee provisions without any conditions. BNPL providers will still need to comply with other CCCFA provisions that apply to them.

Criteria	Assessment
Adequate consumer protection	This option will not provide any consumer protections against excessive default fees that could be charged by BNPL providers.
Compliance costs	BNPL providers will not have to comply with any CCCFA fee provisions and will therefore be able to set their default fees at their discretion. This option will provide certainty as BNPL providers will be exempt from the CCCFA fee provisions without any conditions and will not result in any monitoring efforts from the regulators.
Fair markets for credit	BNPL providers would be allowed to calculate and charge default fees without any restrictions. This will enable BNPL providers to maintain their current business models, operate at a profit, and compete with other small amounts and short-term credit lenders. This will provide consumers with a variety of credit products to choose from. However, it will lead to different regimes across the consumer credit market.

Stakeholder views

89. A BNPL provider believes that this option would increase legal certainty regarding the specific types of costs and losses that can be recovered (and to what extent) compared to option four. It also believes that it would not reduce any consumer protection under existing laws that restrain late fees.

90. An industry body sees this option as addressing the identified problem with the advantage of not creating different regulations for BNPL providers.

91. A financial mentor network opposes any exemption being considered for the reasons already mentioned. The network also mentioned that without any restrictions on default fees that BNPL providers can charge, there is a risk of them increasing these fees, which could aggravate the financial harm caused by BNPL. Furthermore, new lenders could emerge within the exemption loophole with models that put borrowers at even greater risk.

92. Additionally, banks and the Commerce Commission are worried that this exemption would set a precedent in applying different rules for different consumer credit contracts, creating an uneven playing field among lenders offering small amount and short-term loans. The regulator suggested that BNPL providers should still be required to keep (and review) records as to how they have calculated the default fees.

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

	Option One – Counterfactual: Compliance with the CCCFA fee provisions by 2 September 2024	Option Two – Time-limited exemption from the CCCFA fee provisions	Option Three – Exemption from the CCCFA fee provisions conditional on compliance with a default fee cap	Option Four – Exemption from the CCCFA fee provisions conditional on compliance with a reasonable cross-subsidisation of total credit losses through default fees	Option Five – Exemption from the CCCFA fee provisions
Adequate consumer protection	0 Same protections against unreasonable default fees as other consumer credit products	-- Will delay protections from unreasonable default fees	- Protections against unreasonable default fees provided via a cap, but in some circumstances, the level of protections will be lower than under option one	- Protections against unreasonable default fees provided via conditions, but in some circumstances the level of protection will be lower than under the counterfactual option	--- No protections against unreasonable default fees
Proportionate compliance costs	0 High compliance costs Protect Commercial Interests Requirements are clear	0/+ Will enable all BNPL providers to transition Protect Commercial Interests	+ All BNPL providers will need to adjust their fee structure but to a lesser extent than under the counterfactual. Requirements are clear	+ Low compliance costs and greater flexibility, but with a bit less clarity on how the specific conditions need to be applied in practice	++ No compliance costs, clarity that the provisions do not apply
Fair markets for credit	0 While the same requirements will apply to all consumer credit products, it will create a competitive disadvantage for BNPL providers, Protect Commercial Interests	0/+ Will create a competitive disadvantage for BNPL providers when they will have to comply with the fee provisions and might require adjustments to their existing business models, which might negatively impact BNPL providers, the competition in the market and credit choice for consumers. Protect Commercial Interests	0/+ Would standardise BNPL providers’ fee structures but might require adjustments to their existing business models Protect Commercial Interests Different requirements will apply across consumer lending products	++ BNPL providers will be able to operate at a profit, maintain their current business models, and compete with other lenders. Different requirements will apply across consumer lending products.	++ BNPL providers will be able to operate at a profit, maintain their current business models, and compete with other lenders. Different requirements will apply across consumer lending products.
Overall assessment	0	-	0/+	++	+

Key for qualitative judgements:

- ++** much better than the counterfactual
- +** better than the counterfactual
- 0/+** slightly better than the counterfactual
- 0** about the same as the counterfactual
- 0/-** slightly worse than the counterfactual
- worse than the counterfactual
- much worse than the counterfactual
- a lot worse than the counterfactual

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

93. We recommend option four, which would exempt BNPL providers from the CCCFA fee provisions with conditions that provide bespoke protections against excessive fees, which permit some cross-subsidisation for default by other borrowers.
94. We believe that this option delivers the highest net benefits based on the set criteria.
95. Overall, we consider option four strikes the right balance by protecting borrowers against high default fees while also mitigating risks that the new regulations may make BNPL commercial unviable.
96. Unlike options one (counterfactual), two (time-limited exemption), and three (default fee cap), option four will allow all BNPL providers to operate at profit, thereby maintaining their current business models. This would guarantee consumers' continued access to this type of credit and allow them to benefit from BNPL products that are interest-free and fee-free for borrowers who make timely repayments. The availability of credit products and competition among consumer credit lenders would be ensured.
97. In contrast to options two (time-limited exemption) and three (default fee cap), we do not expect BNPL providers to undergo disruptive changes to their default fee structure and merchant agreements, keeping compliance costs low.
98. The conditions attached to option four will ensure that BNPL providers do not charge "unreasonable" default fees (contrary to option five), which could cause further financial harm to BNPL borrowers in default. If option four provides less protection against unreasonable default fees than option one, BNPL providers will still have to comply with section 41A (for the purpose of the exemption). This requires lenders to keep (and review) records about how default fees are calculated. We believe that this requirement will mitigate the risk of BNPL providers charging excessive default fees. The Commerce Commission also mentioned that restrictions on default fees outside of the CCCFA fee provisions will still apply to BNPL providers and would become relevant from an enforcement perspective (such as the unfair contract terms in the Fair-Trading Act).

Section 3: Delivering an option

How will the new arrangements be implemented?

99. If any change is pursued, it will be given effect by regulations under the CCCFA. It is anticipated that any amendment regulations will be made in 2024 and will come into force as soon as finalised to minimise the period during which the current regulations apply (and under which BNPL providers need to comply with the CCCFA fee provisions).
100. The regulatory functions will be undertaken by the Commerce Commission as with other CCCFA regulations, then by the FMA, as the Government has announced the FMA will take on the credit market regulatory functions from the Commerce Commission.
101. The Commerce Commission has been consulted and stated that it does not take different approaches to enforcement of the fee provisions based on lender business models. An exemption would be required before default fees under BNPL contracts could be treated differently to other consumer credit contracts.

102. The Commerce Commission mentioned that to assist with regulatory enforcement, any regulatory changes should ensure that BNPL providers are required to keep (and review) records regarding how they calculate the default fees.

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

103. We intend to check with key stakeholders soon after any confirmed changes to regulations to find out what changes are being made to their fee structure and policy, and the impact of these on lending and borrowers.

104. Additionally, as stipulated in the 2023 RIS, the Cabinet paper includes a commitment from the Minister to review the BNPL arrangements one year after they have come into force. This will also apply to these amendment regulations to ascertain how the exemption with conditions is working and evaluate any potential impact.

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