

In Confidence

Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Growth and Infrastructure Committee

Approval to release discussion paper “Review of Consumer Credit Regulation”, and amend section 99(1A) of the Credit Contracts and Consumer Finance Act 2003

Proposal

- 1 This paper seeks approval for the release of the discussion paper *Review of Consumer Credit Regulation* for public consultation.
- 2 It also seeks Cabinet agreement to amending section 99(1A) of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**), which is a source of significant financial risk for lenders.

Executive summary

Review of Consumer Credit Regulation

- 3 There is a continued problem of consumers being provided with loans that are unaffordable or unsuitable, and ending up in unmanageable debt. This seriously impacts their lives and those of their families. It particularly affects vulnerable people and those already in hardship. Problem debt exacerbates financial hardship and stress, and contributes to persistent, intergenerational poverty.
- 4 The CCCFA aims to protect borrowers by mandating responsible lending, requiring disclosure of key information to borrowers and prohibiting unreasonable fees.
- 5 I initiated a review of the CCCFA (**the Review**) to ensure that legislation is adequately preventing consumer harm. The Review has been one of my key priorities to lift the wellbeing and financial capability of New Zealanders. The aim is to assess the effectiveness of 2015 amendments to the CCCFA, which introduced responsible lending, and identify further improvements required.
- 6 Despite some positive results from the 2015 reforms, initial research and stakeholder engagement shows that there are still serious problems with the high cost of credit, irresponsible lending, predatory behaviour by mobile traders, unreasonable fees and harmful debt collection practices. The attached discussion paper (in **Annex 2**) and summary flyer (**Annex 1**) ask for feedback on the issues identified to date, alongside potential options to address them. These options include interest and fee caps, stricter creditor licensing requirements and stronger enforcement.
- 7 Subject to outcomes of the consultation, I expect to seek Cabinet agreement to a package of further reforms to the CCCFA. My intention is to introduce an amendment Bill to Parliament by the end of 2018.

Section 99(1A) of the CCCFA

- 8 I am also recommending that Cabinet agree to amend section 99(1A) of the CCCFA, which is currently a source of significant financial risk for lenders. Section 99(1A) provides that if lenders

fail to disclose information required by the Act, borrowers are not liable for the payment of any interest or fees over the time that the disclosure went uncorrected. Where many borrowers are involved, this may be a very large amount of money out of all proportion to the seriousness of the disclosure breach. I am asking Cabinet to confirm the previous Government's decisions to amend section 99(1A) to allow lenders to apply to the courts for relief.

Background

Problem debt is a challenge to a productive, sustainable and inclusive economy

- 9 Borrowing money helps New Zealanders support their long-term standard of living, deal with financial challenges and meet their goals. For some, however, borrowing money has the opposite result. There is a continued problem of consumers taking out loans that are unaffordable or unsuitable, and ending up in unmanageable debt. This seriously impacts their lives and those of their families, and particularly affects vulnerable people and those already in hardship.
- 10 Problem debt presents a significant challenge to our ability to build a productive, sustainable and inclusive economy, in line with our goals as a Government.
- 11 Problem debt also has the potential to reduce the impact of child poverty reduction initiatives, as high-interest debt siphons away a significant proportion of the income of families in hardship. Unmanageable debt is the source of ongoing mental, emotional and financial stress for families.

Many vulnerable people have problem debt

- 12 Debt is a widespread problem for vulnerable consumers. A social service provider that works with low income families advised that 95% of its client families were carrying unaffordable debt. This represented 900 children and their families (75% of which were Pacific peoples and 15% Māori). A separate study of 74 Māori Housing New Zealand tenants by a Whānau Ora provider found that 84% of families had debt (including government debt). The families in this sample included 115 children.
- 13 While persons on low incomes are using a variety of avenues to deal with difficult financial circumstances, the use of commercial credit providers is one of these. Approximately 150,000¹ consumers per year are estimated to obtain credit from the high-cost lending market. These consumers often have low credit scores, which limits their access to mainstream credit.

The Government is working to address problem debt and lift financial capability through a number of initiatives

- 14 Problems around irresponsible lending are complex, with multiple contributing factors. This Government is working to address debt problems and lift financial capability through a number of initiatives (shown in **Annex 3**), including:
 - 14.1 The Ministry of Social Development's Building Financial Capability programme provides a spectrum of support for people experiencing hardship.

¹ This estimate is based on information shared with MBIE by three of the largest high-cost lenders.

- 14.2 The Commission for Financial Capability delivers programmes in schools, workplaces and communities.
- 14.3 Legislation introducing the Families Package passed in 2018. This initiative is designed to provide targeted additional social assistance to improve incomes for low and middle income families with children.
- 15 In addition, the lending industry and the community sector are seeking to collaborate with Government in tackling irresponsible lending, and will participate in an industry forum to increase the accessibility of responsible credit.
- 16 Strong, effective consumer protections are needed to underpin these initiatives.
- 17 The CCCFA² was amended in 2015 to mandate responsible lending. For example, lenders must undertake reasonable inquiries to determine that the borrower is likely to repay their loan without substantial hardship. The CCCFA also requires disclosure of key information to borrowers and prohibits unreasonable fees.

A review of the CCCFA is underway

- 18 The Labour Party's election manifesto included a commitment to conduct a review of the CCCFA, as well as to look at interest rate caps and ways to strengthen compliance with the Responsible Lending Code.
- 19 In late 2017, I instructed officials to undertake a targeted review of the CCCFA. The Review has focused on assessing the effectiveness of the 2015 reforms in: (a) reducing predatory and irresponsible lending; (b) enabling better informed decision-making by consumers; and (c) increasing compliance with legal obligations.
- 20 To assess the impact of the 2015 reforms, MBIE officials conducted:
- 20.1 desk-based research, including a study of lenders which gathered publicly available information on lender advertising, disclosure practices and other matters
 - 20.2 structured conversations with 30 stakeholders,³ to provide insights into how different parts of the credit sector were impacted by the reforms (and their overall effectiveness).

Part 1: Overview of discussion paper for public consultation

- 21 There have been some positive results from the 2015 reforms, but serious issues remain. The discussion paper focuses on these problems and proposes options to address them.

Issue 1: Excessive cost of some consumer credit agreements

- 22 Some lenders offer credit products at very high annualised interest rates (up to 800% per annum). Many consumers have little or no savings and when an urgent need arises, they have

² The CCCFA regulates consumer credit in New Zealand. It applies to credit contracts, consumer leases and buy-back transactions of land. All types of lenders are covered by the CCCFA, including banks, credit unions, building societies and finance companies.

³ Stakeholders interviewed included lenders, consumer advocates, industry organisations, debt collection agencies, dispute resolution schemes, community service providers and government agencies.

little choice except to turn to short-term loans to cover budget shortfalls. Problems arising from the use of high-cost loans include:

- 22.1 increased vulnerability to future financial shocks, and significant costs for consumers, reducing their ability to invest or save for the future
- 22.2 debt spirals, as high-cost loans are more likely to result in unmanageable debt which accrues indefinitely, and subsequent financial hardship
- 22.3 that high-cost lenders appear to be disproportionately irresponsible lenders.

23 To address these issues, the discussion paper proposes placing a cap on the amount of interest and fees that lenders can charge. A cap could take one of three forms, and the discussion paper seeks feedback on the costs and benefits of each of the following:

- 23.1 One option is to limit the total accumulation of interest and fees over the life of the loan to 100% of the original loan principal. This option would only apply to high-cost lenders, and would aim prevent unmanageable debt and financial hardship from accumulating large debts from a small loan.
- 23.2 Another option would be to limit the interest rate and fees (calculated together) to 200–300% per annum, as well as limiting accumulated interest and fees to 100% of the original loan principal.
- 23.3 A final option is to set a low interest rate cap to prohibit high-cost lending. The interest rate and fees would be limited to 30%–50% per annum.

Issue 2: Continued irresponsible lending and other non-compliance

24 I am particularly concerned by some lenders' lack of regard for their responsible lending obligations and public disclosure requirements, as these are likely to be causing considerable harm to vulnerable borrowers. Stakeholders have reported problematic instances of:

- 24.1 inadequate affordability testing for loans and no testing of affordability for subsequent loans
- 24.2 aggressive upselling and advertising of high-cost loans to previous customers
- 24.3 inadequate information disclosure.

25 There is considerable uncertainty amongst lenders about how to comply with some CCCFA responsibilities, or what the legislation allows and expects them to do. This lack of clarity may be contributing to non-compliance issues.

26 A range of options have been proposed to address these concerns. These include:

- 26.1 increased lender registration requirements, which would aim to reduce the number of non-compliant lenders in the market

- 26.2 new penalties, additional duties on directors and requirements for lenders to substantiate their compliance with lender responsibilities
 - 26.3 introducing more prescriptive requirements for affordability assessments and lender advertising.
- 27 Another option in the discussion paper is increasing the industry levy on creditors to help fund Commerce Commission credit activities.

Issue 3: Continued predatory behaviour by mobile traders

- 28 Mobile traders are businesses that do not have fixed retail premises and sell predominantly or exclusively on credit or other deferred payment terms. Some of these traders operate mobile shops, usually from trucks, while others employ sales staff who sell goods door-to-door using catalogues and brochures.
- 29 Mobile traders are often lenders for the purposes of the CCCFA, when they sell goods or services through consumer credit contracts.
- 30 Stakeholders have raised continuing significant concerns about mobile traders, including the high cost of goods sold, high rates of non-compliance with consumer laws and predatory and irresponsible behaviour.
- 31 Many of the options to address issues with mobile traders are the same as for other lenders covered by the CCCFA.
- 32 In addition, the paper discusses options to ensure that a larger proportion of mobile traders selling goods on credit are covered by the CCCFA. This includes an option of prohibiting the price of goods or services sold on credit from exceeding the cash price or fair market value. In this case, costs of borrowing would need to be recovered in interest and fees. For example, rather than selling an iPhone 8 for \$4,000 (156 payments of \$25.64), it would need to be sold around the recommended retail price of \$1,249 and costs of borrowing recovered through an annual interest rate (which works out to 101.80%). This would enable any interest and fee caps to be applied to mobile traders.

Issue 4: Unreasonable fees

- 33 Alongside broader non-compliance, some lenders are charging fees that appear to be disproportionate to the cost of the activity and so are not reasonable (whereas the CCCFA requires that fees be reasonable). However, it is expensive and burdensome for the Commerce Commission to prove that fees are unreasonable. Furthermore, the legislation is unclear about which costs can be directly recovered as fees, and which fees must be reasonable.
- 34 I have proposed options for tighter requirements around fees:
- 34.1 Lenders could be required to keep records proving they set their fees at a reasonable level.
 - 34.2 Fee caps could be prescribed for different types of mandatory fees, with other fees prohibited. All other costs and profits would need to be recovered through interest rates.

- 34.3 A third option is to require disclosure and advertising to display an 'equivalent interest rate' that combines interest and fees into a single annual rate, to allow quick comparisons between lenders.

Issue 5: Irresponsible debt collection practices

- 35 MBIE has heard concerns about some debt collection practices, including the use of false and misleading claims, harassment, excessive charges and unrealistic payment demands. Officials were told of situations where a debt collector called the borrower or the borrower's workplace receptionist up to five times a day demanding payment. Another stakeholder noted that it is common for debt collectors to commence their activities by demanding full and final settlement (regardless of the borrower's employment and financial situation). I am particularly concerned that these issues may be disproportionately affecting the most vulnerable consumers.
- 36 The impacts of such behaviour on affected individuals are very serious. However the scale or extent of the problem is not known. Accordingly, the discussion paper seeks feedback to ascertain whether problems around debt collection are systemic or otherwise warrant intervention.
- 37 Potential options to introduce more prescriptive requirements around debt collection activity are canvassed in the discussion paper and include:
- 37.1 increasing disclosure requirements at commencement of debt collection. Key facts of the debt, legal rights, and services available to borrowers (like budget advisory services) could be proactively provided to borrowers at the commencement of debt collection action.
 - 37.2 requiring debt collectors to offer affordable repayment plans
 - 37.3 limiting contact between the debt collector, borrower and other persons
 - 37.4 making all third party debt collection directly subject to the CCCFA. Currently some debt collectors are directly subject to the CCCFA, but only if the debt is 'assigned' to them, for example when they purchase it from the original creditor. Otherwise, creditors are responsible under the CCCFA for the actions of debt collectors, as their agents.
 - 37.5 mandating that only the actual costs incurred by debt collectors – acting as agents of creditors – could be passed on to borrowers.

Part 2: Section 99(1A) of the CCCFA

- 38 I am also recommending that Cabinet confirm the previous Government's decisions on amendments to section 99(1A) of the CCCFA, which is currently a source of significant financial risk for lenders.
- 39 Section 99(1A) of the CCCFA provides that if lenders fail to disclose information required by the Act, borrowers are not liable for the payment of any interest or fees over the time that the disclosure went uncorrected. This section creates strong incentives for lenders to comply with disclosure obligations. However, it unfortunately applies even for very minor breaches (e.g. an immaterial typographical error in a disclosure statement) and it is possible for such a breach to affect many borrowers and to go undetected and unremedied for a long period of time. This

means that lenders may have a large and disproportionate liability to borrowers as a result of a minor breach.

- 40 As long as the section remains unchanged, lenders continue to be exposed to accumulating risk.
- 41 In May 2017 Cabinet agreed that section 99(1A) of the CCCFA be amended, so that in future a lender has the right to apply to a court for relief from the presumption of 100 percent forfeiture of all interest and fees [EGI-17-MIN-0105]. The ability to apply for relief would be available for a limited time following discovery of the breach.
- 42 Cabinet also agreed that, where a lender breaches section 99(1A) of the CCCFA in the period before its amendment:
- 42.1 the lender should not have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the breach (e.g. in September 2015) and the entry into force of the amended section 99(1A) of the Act (e.g. March 2020); but
- 42.2 the lender should have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the entry into force of the amendment (e.g. March 2020) and the date the breach is discovered and remedied (e.g. April 2025).
- 43 I consider this change strikes an appropriate balance between the rights of lenders and borrowers. Lenders will continue to have strong incentives to comply with disclosure requirements, and will have the onus of proving to a court that their liability to borrowers from a disclosure breach is excessive. At the same time, this change provides an avenue for lenders to obtain relief from large and disproportionate liabilities as a result of minor disclosure breaches.

Consultation to date

Review of the CCCFA

- 44 Officials engaged with a wide range of stakeholders during the development of the discussion paper and this Cabinet paper. Government agencies consulted include: the Department of Prime Minister and Cabinet, the Treasury, the Ministry of Social Development, the Ministry for Pacific Peoples, Te Puni Kōkiri, the Commerce Commission, Financial Markets Authority and the Reserve Bank of New Zealand.
- 45 Given the importance of these issues and proposed options, input from range of stakeholders is required to inform final policy decisions.
- 46 I am therefore seeking approval to release the attached discussion paper for public consultation on the identified issues and proposed options.
- 47 Whilst we expect that its contents will be welcomed by a number of industry stakeholders (including consumer advocates), there may be a more sceptical reception by high-cost lenders and other stakeholders (for whom significant changes are discussed as potential options).

Section 99(1A)

- 48 A discussion paper on section 99(1A) was previously published in November 2016. There were a wide range of stakeholder views. A number of lenders and law firms argued that section 99(1A) should be completely repealed and fully retroactive. Consumer groups like Citizens Advice Bureau NZ have generally opposed any change to section 99(1A).

Financial implications

- 49 There are no financial implications expected from releasing the discussion paper.
- 50 Some of the potential options are expected to have financial implications. If they are adopted as final policy recommendations, I will advise you of their financial implications at that time.
- 51 The proposals around section 99(1A) have no financial implications for government. Providing a right for lenders to apply for relief may result in additional cases to the District Court (officials estimate up to five per year), which I expect to be met within existing court funding.

Human rights

- 52 The proposals in the CCCFA discussion paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.
- 53 Similarly, the section 99(1A) proposals are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative implications

- 54 The proposals in the discussion paper are expected to result in a Credit Contracts and Consumer Finance Amendment Bill. This Bill currently has **S 9 (2) (f) (iv)** on the 2018 Legislative Programme.
- 55 **S 9 (2) (f) (iv)**
- 56 The change to section 99(1A) would also be contained in this Bill.

Regulatory impact analysis

- 57 In respect of the discussion paper, the Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in this paper regarding potential amendments to the Credit Contracts and Consumer Finance Act 2003, are exempt from the requirement to provide an Impact Assessment as the relevant issues have been addressed in the discussion document.
- 58 In respect of amendments to section 99(1A) of the CCCFA, the Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in this paper are exempt from the requirement to provide a Regulatory Impact Assessment as the relevant issues have already been addressed by existing Impact Analysis. Refer to the attached Regulatory Impact Statement prepared by MBIE “Consequences for lenders of non-compliant information disclosure: section 99(1A) of the Credit Contracts and Consumer Finance Act 2003.”

Gender implications and disability perspective

- 59 Women, particularly solo mothers, are more likely to be vulnerable consumers. People with long term disabilities are also more likely to be vulnerable consumers. Both groups are likely to be disproportionately impacted by irresponsible lending.

Publicity

- 60 The CCCFA Review has already had significant media attention and I expect more if this discussion paper is publicly released. I will also issue a media statement announcing the consultation.
- 61 To ensure a broad audience – and elicit the information needed to support final policy decisions – MBIE’s website will host online submission templates for both technical and non-technical audiences. This will be supported by two consultation documents: (a) the discussion paper (**Annex 2**) provides plain English descriptions of issues and options, and asks questions geared to a technical audience; and (b) a two-page overview of the key issues and questions has been developed for non-technical readers (at **Annex 1**). MBIE will also provide technical background information for interested parties.
- 62 There will be separate communication to stakeholders informing of the proposed changes to section 99(1A).
- 63 The discussion paper and this Cabinet paper will be published on MBIE’s website, along with the previous Cabinet paper and regulatory impact statement on changes to section 99(1A).

Recommendations

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

Discussion paper

- 1 **note** that MBIE has undertaken initial research to review the Credit Contracts and Consumer Finance Act 2003 (CCCFA), including the 2015 reforms that introduced responsible lending;
- 2 **note** that the review has found some positive results from the 2015 reforms, but serious issues remain, including the high cost of credit, continued irresponsible lending, predatory behaviour by mobile traders, unreasonable fees and harmful debt collection practices;
- 3 **note** the attached discussion paper includes a range of options to address these concerns, including interest rate caps and increasing existing levies paid by lenders;
- 4 **note** that consultation documents have been written to target a wide audience, and that a media strategy is being developed to reach individual consumers;
- 5 **agree** to the release of the discussion paper entitled *Review of Consumer Credit Legislation* (attached at **Annex 2**), subject to any minor or technical amendments that may be required;

Section 99(1A)

- 6 **note** that on 10 May 2017, the Cabinet Economic Growth and Infrastructure Committee agreed that:

- 6.1 section 99(1A) of the Act be amended, so that in future a lender has the right to apply to a court for relief from the presumption of 100 percent forfeiture of all interest and fees;
- 6.2 where a lender breaches section 99(1A) of the Act in the period before its amendment:
 - 6.2.1 the lender should not have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the breach and the entry into force of the amended section 99(1A) of the Act; but
 - 6.2.2 the lender should have the right to apply for relief from the courts, in respect of any interest and fees it must forfeit for the period between the entry into force of the amendment and the date the breach is discovered and remedied [EGI-17-MIN-0105];

7 **confirm** the decision referred to in paragraph 6;

Legislative implications

8 **note** that the Credit Contracts and Consumer Finance Amendment Bill currently has **S 9 (2) (f) (iv)** on the 2018 Legislative Programme;

9 **S 9 (2) (f) (iv)**

10 **note** that the Bill should be introduced no later than Monday 10 December 2018;

11 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to paragraph 6;

12 **authorise** the Minister of Commerce and Consumer Affairs to make minor or technical changes, consistent with the policy framework in this paper, on any issues that arise during drafting;

Communication

13 **note** that the discussion paper, this paper, and the previous Cabinet papers relating to section 99(1A) will be published on the Ministry of Business Innovation and Employment's website.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

Annex 1: Overview of the discussion paper (2 page flyer)

Annex 2: Discussion paper

Annex 3: Broader context for CCCFA Review

