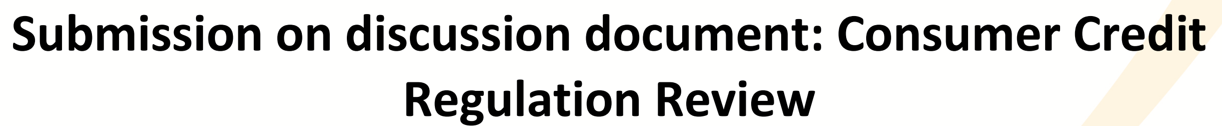

Submission on discussion document: Consumer Credit Regulation Review

Cash Converters

August 2018

cashconverters

Introduction

Cash Converters is New Zealand's largest provider of small amount loans as well as the largest buyer and seller of second hand goods.

Cash Converters has been active in New Zealand for 25 years. We directly employ 380 people and operate 28 stores across the country. Each week we help thousands of everyday Kiwis get on with their lives with responsible financial solutions.

Cash Converters has contributed to consumer credit reform for 12 years. We promote responsible lending practices and have a long-standing reputation for ethical conduct and the provision of responsible services in New Zealand. Cash Converters is a vocal supporter of responsible lending principles and the Responsible Lending Code.

We have responded to the discussion document questions where we have relevant experience.

We would be pleased to provide further information useful to the Ministry during the review. If there are any questions please contact Erin White ( ) or Andrew Kamp ( ). We would also welcome the opportunity to provide an oral submission at the select committee stage.

Responses to discussion document questions

Regarding the excessive cost of some consumer credit agreements

1	Do you agree that the problems identified with high-cost lending (even where it is compliant with the CCCFA) are significant? Do you have any information or data that sheds light on their frequency and severity?
	Small amount loans are often the lowest cost available option to help maintain financial inclusion. Overwhelmingly they are provided responsibly and work well for both borrower and lender. It's unfortunate that the hundreds of thousands of good loans each year are overlooked, though it is acknowledged there remain a small number of lenders who disadvantage customers by engaging in unscrupulous behaviours and who damage the reputation of the entire industry. Cash Converters' experience is that consumer detriment is driven by small number of lenders who either don't comply with existing CCCFA and responsible lending obligations, or who unfairly profit when a customer falls into default by charging higher interest rates or large fees. **Financial harm from frequent use of high-cost loans** There is a view that many, or even most, high-cost credit users are frequent borrowers locked into a cycle of debt. This is not the case. Our experience, during more than 20 years of providing financial solutions, is a customer will tend to use small value loan products up to a few times over a period of months, then not require those products for some time. Typically, this occurs due to some unexpected event where the consumer requires a small amount to assist with cash flow over a short period of time for an unexpected bill, or car repair for

	example. On average, a customer transacts with Cash Converters about three times over 12 months. Over a three-year period, this falls to 1.5 per year. We have seen cases discussed where a consumer has 15 or 20 small loans over the course of a year though our experience is that less than one percent of customers reaches 12. Cash Converters continues to review its products and process to actively reduce high frequency customers. **Debt spiral** We agree debit spiral is an issue which needs to be addressed. Those lenders who behave within existing legislation and guidelines are unlikely to create a situation where debt spiral occurs. Cash Converters has operated a voluntary 100% cost of credit cap for many years, which ensure our products do not contribute to debt spiral. **Uncompetitive rates** It's common, and easy, to assume that because small loans have high headline rates that the cost is uncompetitive and the margin is large. It isn't. Rates are high because compliant small amount loans are costly to provide[1], not due to an uncompetitive market. Margins for compliant commercial lenders are slim. As a direct example, FY18 is our best year since the 2015 CCCFA reforms with profits at 3% of revenue. We know some small amount lenders are already operating at a loss and believe others are not doing much better. In contrast, each of the Big 4 banks achieved net profits between 40.5% and 44.8% of revenue[2] over a comparable period.
2	Do you support any of the extensions of Cap Option A? What would be the impact of these extensions on borrowers, lenders and the credit markets? Do you have any information or data that would support an assessment of the impact of these extensions?
	Cap Option A functions as a very effective safety net to those lenders or loan products which truly exploit consumers. While the overwhelming majority of credit contracts do not approach the 100% limit on total cost of credit, consumers are protected from an unreasonable outcome where things do not go to plan. Our strong experience is a customer will tend to use small value credit products a few times over a period of months allowing them to address the issues causing them to seek finance, and then not require those products for some time. This is illustrated by the usage pattern

[1] For an external example, see the NAB Small Loans Pilot (https://www.nab.com.au/content/dam/nabrwd/About-Us/corporate-responsibilty/docs/nab-small-loans-pilot-report.pdf) which found small loan administration cost $321 per loan almost 10 years ago. The cost today is materially higher after inflation and introduction of stringent compliance requirements such as responsible lending obligations and enhanced AML/KYC processes.

[2] NPAT as a function of revenue:
ASB – 44.8% (https://www.asb.co.nz/content/dam/asb/documents/legal/disclosurestatements/ASB-DS-Jun-2017.pdf, p3)
ANZ – 44.4% (https://www.anz.co.nz/resources/9/0/902b57b7-24e0-4af3-9a74-8fbc074a3b83/ANZB+DS+Sep17.pdf?MOD=AJPERES, p3)
BNZ – 40.5% (https://www.bnz.co.nz/assets/about-us/financials/pdfs/bnz-financial-disclosure-statement-2017-09-30.pdf?v=1, p7)
Westpac – 42.3% (https://www.westpac.co.nz/assets/Who-we-are/About-Westpac-NZ/Disclosure-statements/September-2017/Westpac-New-Zealand-Disclosure-Statement-September-2017.pdf, p15)

cashconverters

	described above. The proposed extensions, particularly a "cooling off" period, lock consumers out of the option to borrow for a material period of time. This will force consumers to borrow more than they would otherwise need at a higher total cost to allow a "buffer" in case of an unexpected event or look to unregulated sources for credit. Both of these outcomes increase the total cost of credit and are to the consumer's detriment. Accordingly, we do not support the extensions to Option A. We have proposed an alternative extension below in item 4.
3	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
	We are concerned the sensitivity of the small value loan market to these changes is understated. With the CCCFA already capping credit fees well below the lender's actual cost[3] interest is the only avenue available to recover the bulk of the cost of lending. Capping interest rates will force consumers into higher value, longer term, loans when they only really need and want a smaller amount. Our smallest value loans are already unviable. We provide the loans as a customer service to help our customers avoid the need to borrow more than they really need, but still we receive feedback from consumers (and some budget services) that they are disappointed we cannot offer even smaller loans. In respect to the specific options outlined: **Option A** A 100% cap can maintain financial inclusion but force lenders who generate their profits from defaulting customers to amend their products and will remove the current opportunity for real harm. This will be a positive change, and we support this option. **Option B** Short term loans carry all the same costs as longer-term credit including: • Cost of funds • AML/KYC • Credit checks • Obtaining bank statements and other financial information • Conducting affordability assessment • IT systems • Contact centre and customer service costs etc

[3] Many substantial costs can't be recovered via fees, such as most fixed costs (such as rent), the costs of assessing loans which are refused, cost of capital, marketing costs, and losses incurred on loans which go bad, meaning interest is the primary means by which costs are recovered. See *Consumer credit fees – Guidelines,* Commerce Commission (June 2017)

cashconverters

but the small value and short term of the loan produce a small total cost of credit, even with a high headline rate, from which to recover these costs.

We have seen misleading commentary in respect to markets frequently used for comparison with NZ, such as the UK and Australia, for example suggesting that Australia has a 48% interest rate cap[4] on short term loans. The equivalent credit agreements in those markets have implemented caps around 300% pa[5].

300% caps at this level have caused even the largest and most efficient lenders to exit the Australian short-term segment[6] and have had a similar effect in the UK where the FCA noted the number of lenders contracted significantly after the caps were implemented and that many lenders were unprofitable and exiting the market[7]. Accordingly, financial inclusion and access to small value loans has been significantly eroded.

Predictably, lenders have moved to offering larger, longer loans which allow the lender to cover their costs with a greater total cost to the consumer[8].

We believe caps will likely establish a new lending floor of $2,000 or greater where products remain commercially viable. Loan terms will increase, extending time the consumer is burdened with payment obligation and the total cost of credit paid by the consumer will increase even though the headline rate has fallen significantly. Only providers who run the gauntlet and choose not to comply with regulations will be able to operate below the floor.

Our borrowers currently seek smaller amounts and shorter loans to help limit their debt exposure. Often these borrowers do not trust, or are already excluded from, mainline credit such as credit cards[9]. These borrowers will be almost entirely excluded from responsible, regulated credit under this option.

Some suggest non-commercial and charitable loan schemes should step in to service those consumers who would otherwise be excluded from credit. We support provision of no-interest and low-interest loan schemes to truly vulnerable consumers. However, these schemes typically have restrictive borrowing criteria[10]. These restrictions currently exclude nearly all small loan borrowers.

---

[4] See, for example: https://www.newsroom.co.nz/2018/07/03/139295/nz-loan-sharks-a-real-underbelly suggesting Australia has a 48% interest rate cap on all loans, and the UK has a 100% interest rate cap. Both suggestions are incorrect.

[5] Australia allows fees of 20% up front plus 4% per month, giving an effective APR of up to 547.5%. The APR for a typical 30-day loan is 292%. The UK allows 0.8% per day, or 292% pa.

[6] All ASX listed lenders, with the exception of Cash Converters Australia, have ceased providing Small Amount Credit Contracts.

[7] The number of loans issued in the UK fell by more than 60% see, for example *Impact of regulation of High Cost Short Term Credit*, Consumer Finance Association (2017).

[8] Reference UK studies

[9] For example, less than 9% of Cash Converters customers have a credit card, in many cases because open-ended credit and undefined repayment terms are a bad match for the customer's needs

[10] For example, Nga Tangata Microfinance and Good Sherherd require borrowers hold a Community Services Card. Good Shepherd further requires the borrower to have lived at the same address for more than 3 months. Good Shepherd loans are typically only available for purchasing household goods and limited medical or education expenses (see http://nils.org.nz/#qualify).

Further, these schemes will require very large ongoing external subsidies to maintain financial inclusion[11]. These subsidies, and the requirement for public funding, would need to increase by several orders of magnitude in order to maintain financial inclusion.

Under this option:

- tens of thousands of New Zealanders will suffer a loss of financial inclusion (due to responsible providers being forced to exit the market); and
- tens of thousands more will be forced into larger, longer loans with a higher total cost;

  or

- tens or hundreds of millions of dollars of Government funding will be required to subsidise not-for-profit providers in order to maintain financial inclusion.

Option C

Option C will result in financial exclusion for most of our customers and will entirely remove small amount loan providers. We strongly oppose this option.

As with Option B, non-commercial and charitable schemes are unable to meet the demand for short term loans that will result from adoption of Option C.

4	Do you have any suggestions for the design of options for capping interest and fees? If so, what would be the impact of your proposed design on borrowers, lenders and the credit markets?

We propose:

- Adopting a 100% cap on fees and interest (Option A); and
- adding a 'no debt spiral' extension. Where a lender knows, or should reasonably know, the consumer is in default under an existing high-cost loan, any new loan (if one can be made responsibly) is restricted to lending an amount equal to, or less than, the original principal amount borrowed by the consumer.

Option A already delivers ultimate protection against lenders who unfairly profit by charging higher interest rates or large fees when a consumer misses a payment or is in default.

Where a consumer is exhibiting signs of repayment difficulty the existing responsible lending provisions will often prevent further loans. In cases where it is responsible to provide credit, the 'no debt spiral' extension further protects consumers by ensuring their credit exposure cannot grow.

The 'no debt spiral' extension still provides financial inclusion for consumers who need to re-borrow for an unexpected reason.

5	Which interest rate cap options, if any, would you prefer? Which interest rate options would

[11] For example, NAB have provided more than $130m in funding to support Speckle – the small loan scheme provided by Good Shepherd Microfinance in Australia. On top of this funding, Good Shepherd also received tens of millions of State and Federal Government funding to support administration costs.
This program provided only 27,000 loans during 2017. Cash Converters alone provided support to more than 300,000 people in New Zealand during that period.

	you not support? Please explain how you made your assessment.
	We support Option A. Option A allows preserves financial inclusion, prevents lending practices which profit from consumer difficulty, and provides a strong consumer safety net. We do not support Options B and C for the reasons outlined above. We believe both option B and C will substantially harm financial inclusion, impede or eliminate access to credit for a large number of consumers and represent a material net detriment to those the CCCFA aims to protect.

Regarding continued irresponsible lending and other non-compliance

6	If directors have duties to take reasonable steps to ensure that the creditor complies with its' CCCFA obligations, should any duties apply to senior managers?
	We believe senior managers should be subject to similar duties as have been proposed for directors for the reasons contained in the discussion paper.
7	If there are to be more prescriptive requirements for conducting affordability assessments, what types of lenders or loans should these apply to?
	We already receive frequent negative feedback from consumers objecting to the intrusiveness of the current affordability assessment into their personal, financial and lifestyle choices. In many cases the consumer feels the current assessment goes further than required to establish affordability and begins to imply judgement regarding their lifestyle choices. Similar consumer resistance is becoming apparent in markets like Australia and the UK[12]. Introducing prescribed affordability questions will exacerbate this sentiment by causing lenders to ask irrelevant questions. Accordingly, we do not support a prescriptive affordability assessment. However, if prescriptive requirements are implemented they should apply to all lenders and loan types. All lenders need to assess the transaction against the same basic responsibility principles. Under the Responsible Lending Code, high-cost lenders are already subject to a higher bar in this respect.
8	Should there be any change to the requirement that lenders can rely on information provided by the borrower unless the lender has reasonable grounds to believe the information is not reliable? What would be the impact of such a change on borrowers, lenders and the credit markets?
	Lenders, particularly those offering high-cost credit products, are already required to obtain and review a substantial amount of information. A large proportion of the information reviewed focusses directly on the borrower's income and expenses. Further, lenders who are wilfully unaware of basic income and expense information cannot meet the requirement to make reasonable inquiries and already fail to meet existing responsible lending principles. We argue there is presently wide scope for the lender to become aware, on reasonable

[12] See, for example, http://www.dailymail.co.uk/news/article-5929541/How-morning-coffee-netflix-subscription-home-loan-application-rejected.html.

	grounds, that information may not be reliable. Finally, we strongly support retaining a baseline level of borrower responsibility in conjunction with the substantial lender responsibilities imposed. Removing any responsibility from the borrower to truthfully answer lender inquiries is inherently unhealthy and fosters a dangerous dynamic between lender and borrower. It incentivises the borrower to provide exaggerated, or even completely false, information to obtain loans which are beyond their capacity, and then rely on the lender to protect the customer. This principle of borrower responsibility is supported by organisations such as the National Building Financial Capability Charitable Trust, and the former Federation of Family Budgeting Services via the Code of Responsible Borrowing[13].
9	Do you consider there should be any changes to the current advertising requirements in the Responsible Lending Code? If so, what would be the impact of those changes on borrowers, lenders and the credit markets?
	We believe the current advertising requirements are operating well.
10	Do you agree with our assessment of the costs and benefits of the options to reduce irresponsible lending and other non-compliance? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
	We agree with the costs and benefits outlined in the discussion paper.
11	Do you have any suggestions for the design of options for reducing irresponsible lending and other non-compliance? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
12	Which options for reducing irresponsible lending and other non-compliance would you support? Which would you not support? Please explain how you made your assessment.
	Registration We support Registration Options A and B. Additional powers to remove recidivist lenders and requiring lenders to be "fit and proper persons" for the purposes of providing credit are both critical steps in removing unethical and unreasonable practices from the industry and ensuring lenders responsible for those practices cannot easily re-enter the market. We do not have any objection to Registration Option C, but acknowledge it is potentially quite costly to establish and administer a comprehensive registration scheme. Such as scheme is also likely to increase lender costs with limited additional benefit over Options A and B. **Enforcement** We support enforcement Options A, D and E.

[13] See http://www.nbfcct.com/uploads/1/0/9/1/109133047/the_code_of_responsible_borrowing.pdf

Continued and improved enforcement of the CCCFA and responsible lending principles is positive for the entire credit industry. Cash Converters already engages openly with consumer advocates. We believe requiring all lenders to operate in good faith will produce better outcomes for consumers and, ultimately, for lenders.

We do not support Enforcement Option C.

Responsibility

We do not support Responsibility Options A and B for the reasons discussed above.

We support Responsibility Option C.

Regarding continued predatory behaviour by mobile traders

13	Do you agree with our assessment of the costs and benefits of the options for covering additional credit contracts under the CCCFA? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
14	Do you have any suggestions for the design of options for covering additional credit contracts under the CCCFA? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
	Where a consumer receives goods or a service and defers payment they have obtained credit. The amounts and repayment terms of style products mirror many high-cost credit agreements. However, the position taken by style credit providers is they can provide credit to anyone, and they have no responsibility in respect to vulnerable consumers. The consumer is exposed to all of the risks associated with a credit contract but, style lenders contend the consumer is not entitled to any protections. The credit provider should be required to meet the same standard of care and diligence as any other credit provider, including meeting the responsible lending principles and conducting an affordability assessment. If there is any doubt, credit provided under deferred payment arrangements should be explicitly included in the CCCFA.
15	Which options for changes to cover additional credit contracts would you support? Which would you not support? Please explain how you made your assessment.
	We support Option A on the basis it is the simplest option for consumers to understand and for both providers and the regulator to monitor and manage.

Regarding unreasonable fees

16	If prescribed fee caps were introduced, who should they apply to, and what process and criteria should be used to set them?
	Fees associated with credit contracts are already capped at well below the lender's actual cost[14]. On this basis, we do not support prescribed fee caps. However, if introduced, fee caps should apply to all lenders and all loan products equally. All lenders are subject to the same, or very similar, establishment and administration activities. In fact, high-cost lenders often have additional establishment and verification costs under the higher bar set for them in the Responsible Lending Code. Applying fee caps to high-cost loans and not to other lenders would harm financial inclusion and be illogical.
17	Do you agree with our assessment of the costs and benefits of the options for capping interest and fees? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
	The operation of these options is tightly bound with the options for capping interest discussed above. In combination the two options carry a substantial risk of amplifying each other to exacerbate the associated costs and disadvantages. This is particularly evident in the high-cost credit sector where loan values, and real dollar cost of credit, are already substantially smaller. **Option B** The underlying activity and obligations associated with primary credit fees (such as establishment fees, account keeping fees and default fees) are the same regardless of loan size. Banded fee caps do a very poor job of managing this. It is inherently unreasonable for two loan providers, who are required to complete substantially the same work, to operate under different capped fee amounts. In the case of smaller value loans, a reduction in fees cannot be recouped via interest if interest caps are added. This will force borrowers to migrate to larger, longer loans with a higher total cost. **Option C** While we have no objection to Option C, we note that yet another method of describing cost of credit is likely to be confusing to many consumers.
18	Do you have any suggestions for the design of options for reducing unreasonable fees? If so, what would be the impact of your proposed options on borrowers, lenders and the credit markets?
19	Which options for changes to fees regulation would you support? Which would you not support? Please explain how you made your assessment.
	We support Option A. Lenders are already required to assess credit fees to ensure they

[14] Fees cannot recover many legitimate loan costs. For example, declined applications are a necessary part of any loan business but the costs of processing and assessing declined applications cannot be recovered fees in any way. See *Consumer credit fees – Guidelines,* Commerce Commission (June 2017).

	represent the associated costs. We do not support Option B for the reasons above. We have no objection to Option C.
20	Have you seen issues with excessive broker fees, or other unavoidable fees charged by third parties, being added to the loan? If so, are there any specific changes that should be made to the regulation of third-party fees? What would be the impact of these changes on lenders, borrowers and third parties?

Regarding irresponsible debt collection practices

21	Is this an accurate picture of the problems for consumers experiencing debt collection? Do you have information that confirms or refutes these issues, or sheds light on how widespread or severe they are?
22	What information should be provided to borrowers by debt collectors? When and how should this information be provided?
23	Do you agree with our assessment of the costs and benefits of the options for addressing irresponsible debt collection? Are any costs or benefits missing? Do you have any information or data that would help us to assess the degree or estimate the size of these costs and benefits?
24	Do you have any suggestions for the design of options for addressing irresponsible debt collection? In particular, what is an appropriate frequency of contact with debtors before (and then after) a payment arrangement is entered into? Please state the likely impact of your proposed options on borrowers, lenders and the credit market.
25	Which options for changes to the regulation of debt collection would you support? Which would you not support? Please explain how you made your assessment.

Regarding other issues

26	Are you seeing harm from loans to small businesses, retail investors or family trusts as a

	result of them not being regulated under the CCCFA?
27	Do you think small businesses, retail investors or family trusts should have the same or similar protections to consumers under the CCCFA? Please explain why/why not.
28	Are there any other issues with the CCCFA or its impact on vulnerable people that are not addressed in this discussion paper? If so, what options should MBIE consider to address these issues?