Stage 1 Cost Recovery Impact Statement: Fit and proper person assessment for consumer credit providers

Status quo

A description of the activity and why it is undertaken

In December 2017, MBIE began carrying out a targeted review (**the review**) of the 2015 amendments to the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). In June 2018 a discussion paper was released for consultation with the public. Post-consultation, MBIE has made a series of policy recommendations to the Minister of Commerce and Consumer Affairs regarding amendments to the CCCFA to improve the enforcement of the law and improve protections for vulnerable consumers.

One of the recommendations, which the Minister has agreed to, is the introduction of a fit and proper person test. This test would apply to directors and senior managers[1] of consumer credit providers as a pre-requisite to registration on the Financial Service Providers Register (**FSPR**). Registration on the FSPR is currently a legal requirement to lend in New Zealand.

The barriers to entry into consumer credit lending are low. FSPR registration and being a member of a dispute resolution scheme are all that are required. This is likely contributing to irresponsible lenders and the pervasiveness of ‘phoenix’ lenders who move their lending operations between companies and thus FSPR registrations to avoid enforcement.

A fit and proper person test will better restrict irresponsible lenders and phoenix lenders from being able to enter and operate as consumer credit lenders. This will reduce the harm that these irresponsible lenders cause to consumers, especially vulnerable consumers.

The fee will be charged by the Commerce Commission who will administer the application process.

What policy outcomes will the activity achieve?

The fit and proper person test aims to reduce the operation and involvement of irresponsible and predatory lenders in consumer credit lending by increasing the bar required to register on the FSPR. Achieving a reduction in irresponsible lending and the number of phoenix lenders will reduce consumer harm and improve overall compliance with the law.

What is the rationale for government intervention?

As mentioned, the current entry requirements to engaging in consumer credit lending are low and the 2015 responsible lending amendments to the CCCFA did not achieve as great a

[1] The recommended definition of ‘senior manager’ is proposed to align with the definition of ‘senior manager’ in the Financial Markets Conduct Act 2013, namely a person who is not a director but occupies a position that allows that person to exercise significant influence over the management or administration of a company (for example, a chief executive or a chief financial officer).

reduction in irresponsible lending as desired. Government intervention by way of introducing a fit and proper person test for directors and senior managers is required to change the legal requirements for registration and operation in consumer credit markets.

Statutory authority to charge

The policy recommendations from the review include proposed amendments to the CCCFA which would include legislating for a fit and proper person test. These amendments would also include the ability for an appropriate statutory authority to charge a new fit and proper person test application charge on a cost recovery basis. The exact amount of the charge would be set by an Order in Council.

Policy Rationale

Cost recovery is appropriate for the fit and proper person test application charge as the individuals to whom it will apply directly gain and benefit from being able to operate in consumer credit lending. As a result, it is appropriate for these individuals to bear the cost of assessing and ensuring that they are fit and proper persons to engage in consumer credit lending.

Full cost recovery is being proposed for the costs involved in a fit and proper person test as the costs to individuals are likely to be minimal in comparison to the benefit gained in operating in the market, while the costs involved to the administering agency is likely to be large when the total number of applications and taken into account. In addition, cost recovering on a partial basis only would mean that the shortfall in resourcing and funding of administering the test would need to be met by redirecting other funding already apportioned to specific regulatory or enforcement functions of the regulator. This would likely see a drop in quantity of other, still important, regulatory activities.

As the charge for a fit and proper person test is imposed on a specific individual for the service which is directly provided and benefits that individual by allowing them entry and operation in consumer lending, it is most appropriately classified as a cost recovery fee.

Directors and senior managers of consumer credit providers (or in practice more likely the creditor which they are employed by) will pay the cost recovery charge on a per person per assessment basis. Based on Commerce Commission data, an estimate of the number of lenders operating in the consumer credit market is approximately 420 lenders. Some of these lenders are already captured by a similar fit and proper person assessment under similar regimes such as the Financial Markets Conduct Act 2013 and the Reserve Bank of New Zealand Act 1989 so the number is likely to be slightly lower. It is also planned to require re-confirmation of the fit and proper assessments of directors and senior managers every 3 years at a lower cost as the re-confirmation process would likely involve less time and resources.

The Commerce Commission has estimated an average of 4 directors or senior managers per consumer credit provider. Based on this there could be approximately 1,700 directors and senior managers liable for a fit and proper assessment. There is likely to be a large number of applications in the first series of assessments as all existing consumer credit providers would need to have their directors and senior managers apply. Over time re-confirmations would be sought and new applicants would enter the market and apply for assessments for the first time.

High level cost recovery model

It is envisaged that there would be two different charge levels: one for an assessment and one for a re-confirmation of a previous assessment if no changes in circumstances have occurred. The initial assessment cost has been estimated to be approximately $1,247.75 with the re-confirmation estimated to be approximately $534.75.These figures are GST inclusive.

These estimates have been calculated based on the assumption that the initial assessment would take 7 hours per application while the re-confirmation would take 3 hours per application. The hourly rate used is same as the rate at which the Financial Market Authority (**FMA**) charges for its similar assessments:

Initial application fee = 7 hours x $178.25 = $1,247.75
Re-confirmation application fee = 3 hours x $178.25 = $534.75

The main cost drivers of the fit and proper person assessment are the operational investigation/assessment time spent by relevant staff in assessing applications and the overhead costs of setting up and maintaining the systems which manage and contribute to the management of the assessments.

Both direct costs e.g. staff salaries (including on-costs, such as training, superannuation and leave) and indirect costs e.g. staff in corporate roles such as finance and human resources, corporate overheads and equipment and office space are encapsulated within the hourly rate figure of $178.25. The FMA's hourly rate also takes into account both direct and indirect costs into one hourly rate.

A major assumption underlying the fee estimates is that the hourly rate will reflect the FMA's rate used for the estimations. Likewise, the time taken to assess and complete an application is assumed to take no longer than 7 hours. Should these estimates be too low/high the actual costs and thus fee associated with assessing an application would be higher/lower than the estimates.

We consider that this proposal is consistent with The Treasury's Guidelines for Setting Charges in the Public Sector.

Consultation

Consultation by way of continued contact and regular meetings has occurred with the Commerce Commission as the regulator who will be responsible for the fit and proper person test and the FMA as a regulator with experience in managing and carrying out such a test. This consultation included considerations regarding the design and charging options for the fit and proper test as well as the amount of the charge.

The Commerce Commission is supportive of the proposal to charge application fees on a full cost recovery basis on the condition that the charge actually captures the true cost borne by them in assessing applicants and that the initial setup of the test is sufficiently funded.

The FMA is also supportive of the proposal on the condition that roles and responsibilities of the Commerce Commission, FMA and the Companies Office as registrar of the FSPR in the administration and management of the test are clearly defined.

As the detailed cost recovery model is developed and implemented regular meetings with all three parties (Commerce Commission, FMA and MBIE) will take place to allow continued discussion and collaboration.

When the CCCFA Amendment Bill is progressed through the legislative process there will also be opportunity for key stakeholders and the public to engage and provide feedback on the proposal and the principle of a cost recovery application fee during the Select Committee process