Evaluation of the No Asset Procedure

Final Report

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Executive Summary

The No Asset Procedure (NAP) was introduced in December 2007 as a means to assist people who have no available assets or insufficient income to repay debts up to $40,000 without entering bankruptcy. The programme has assisted over 7,000 people since implementation, and the cost to government for administering the programme is estimated at around $2 million each year.

The policy was introduced after review of the insolvency law, owing to changes in the types of debtors applying for bankruptcy. Cabinet Paper EDC (02) 90 stated that an increasing number of bankrupts were ‘consumer bankrupts’, consisting of a high number of beneficiaries, on low incomes, with a pool of debt comprising utilities debts, IRD debt, credit card debt and loans from finance companies or banks.

The evaluation reported here aimed to assess a) the cost-effectiveness of NAP (compared to other options), b) the impact of the scheme on users, c) the reach and uptake of NAP, and, d) the quality of the scheme administration.

The study covered debtors who were eligible to use NAP (this group comprising disproportionate numbers of beneficiaries, people on low incomes and unemployed people), Non-Government Organisations (NGOs), budget advisers and administrators who dealt with NAP applicants, and creditors and financial institutions.

The following key points and major findings from the evaluation were noted.

Key points

Outcomes

- NAP is successful in achieving social and economic goals of the policy.
- NAP is beneficial in assisting in genuine situations of indebtedness and providing a fresh start.
- NAP should remain as an available option for people in difficult, unmanageable debt situations, especially ‘no fault’ insolvency situations.

Effectiveness

- NAP provides a short-term solution for people in serious debt.
- NAP does not provide a catalyst for people to adopt long-term responsible fiscal behaviour.
- NGOs and budget advisers have a vital role in the operation of NAP and its effectiveness for debtors.

Responsiveness

- NAP administration is highly efficient but should continue to be refined to meet policy objectives.
- NAP refinements need to include appropriate procedures and initiatives that will enable debtors to best deal with their insolvency responsibly and to develop good budgeting practice.
- NAP users value the quality of service provided by ITS staff, and recent changes by ITS will improve the on-line NAP application process.
- NAP has had unintended consequences (including some users using NAP inappropriately) and unintended costs which can be reduced.

Major findings

Positive outcomes from NAP

The evaluation showed that there are real social and economic benefits from NAP for people in genuine, unmanageable debt situations. For many people, where mistakes or life-events lead to serious debts, NAP provides the only viable option for dealing with their indebtedness and improving their lives. Accordingly, NAP debtors were very positive about how NAP had assisted both their social and financial situations – NAP provided a fresh start for many of these people.

Budget advisers and scheme administrators also saw benefits of NAP (93% of budget advisors surveyed rated NAP as a worthwhile government policy). However, they also reported frustration that longer-term strategies for financial management tend to be by-passed after immediate debt situations are dealt with by some debtors. Furthermore, it was found that good alternatives to NAP exist through repayment routes for some debtors, and some budgeting groups actively support these routes.

Creditors saw the benefits of NAP as one-sided and mostly to their disadvantage (initial estimate of debt write-off under NAP is $149M, although, arguably, this amount would be written-off under alternative procedures), with no compensatory procedures to promote fiscal responsibility by debtors. Also, there is 'misuse' of the scheme by some applicants, but costs here can be avoided through reducing misuse.

Attractive, but reactive scheme

Overall, NAP has attracted more than expected numbers of debtors (while growing numbers of insolvencies is a worldwide occurrence in recent years). For some NAP clients other options for dealing with debt, such as Summary Instalment Orders (SIO) or debt repayment may be more effective.

The benefits from NAP may tend to be short-term, especially where debtors are focussed primarily on dealing with the immediate debt problem, rather than, where relevant, the wider matters of how they manage money and the choices that led to their indebtedness.

In itself, NAP does not appear to provide a catalyst for people to adopt better ways of handling their money long-term.

There is a body of evidence to suggest that budgeting skills or financial counselling should be introduced as a condition of NAP. International best practice guidelines suggest that this can be beneficial[1]. However, it is important to recognise that conditional counselling on budgeting will not apply to all situations, particularly 'no fault' insolvency situations.

NGOs and budget advisers have a vital role in the operation and effectiveness of NAP. For many users, NGOs and budget advisers are the gateway to NAP, providing important social networks for debtors who are trying to deal with their respective situations, as well as providing expertise and practical support in the NAP process and on-going support where debtors want to change how they manage their money.

Creditors, including banks, indicated that NAP had negatively affected their likelihood of providing future credit to NAP debtors. The long-term impact of this 'blacklisting' is difficult to determine, but it may become more problematic as the numbers of NAP debtors continues to grow.

Furthermore, financial institutions' lending behaviours have contributed to some NAP debtors' situations by compounding unsustainable debt problems. Budget advisers raised the possibility of government influence on creditor's behaviour – e.g. providing guidelines to the financial sector around marketing of lending to people with little means to repay or with no assets.

Administrative responsiveness

NAP applicants often do not have a good understanding of the scheme. Misunderstandings about NAP come from the widespread use of informal channels for information about NAP (e.g. word-of-mouth), which either makes the scheme overly attractive for some people or deters others from applying.

The use of official language, as well as a long, repetitious English-only application form, and an on-line system that is a challenge for people who are not confident with Internet-based systems contributes to misunderstandings about NAP and may deter eligible people from applying for NAP.

There may be value in raising awareness of the option of NAP for less well represented groups. However, there may be value also in raising awareness of alternative repayment routes, such as SIO, where this may be a possibility for some debtors.

"Gaming" behaviour among NAP debtors and misuse of the procedure[2] indicates a clear need for further safeguards to be introduced to the procedure to further reduce the risk of misuse.

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[1] See appendix for summary of INSOL good practice guidelines on insolvency.
[2] As defined by criteria around which the Official Assignee can refuse entry to NAP.

A number of different government departments deal with clients in NAP. Inter-departmental administrative procedures could be better co-ordinated across government. Interactions with KiwiSaver private sector providers' could be improved.

This report includes suggestions for improving the application process for NAP. Although the application process is onerous – in part to discourage gaming – the process is being streamlined. Recent changes by ITS have improved the on-line NAP process. Such changes will address points raised in the evaluation. However, it is also important to recognise that ITS staff provide a quality service that is valued by NAP users.

Cost-effective, but still costly

One of the objectives of NAP is to provide a cost-effective alternative to administering bankruptcy for the state. Analysis of time-code data shows that NAP has achieved overall savings of approximately 4.5 FTEs per year[3] for the Insolvency and Trustee Service. NAP in the long-run may also have saved some funds in reduced write-offs of student loans. An estimate of this value stands at approximately $2m per year[4], but this figure remains unverified, and is unlikely to have accrued presently.

An unintended consequence of NAP has been the administrative and compliance costs incurred by other parts of government (such as the Ministry of Social Development) and the private sector. Creditors in both government and the private sector are concerned that these unintended costs are significant.

Further evaluative and policy work should be undertaken to gain a full and accurate picture of the costs and benefits of NAP legislation. However, it is unknown whether the costs incurred from NAP would otherwise have occurred from bankruptcy applications. It appears that NAP has enabled some debtors to apply for insolvency that may not have applied for bankruptcy otherwise, and, instead, may have pursued repayment routes over time. It is unknown to what extent NAP has encouraged this. The evaluation suggests some policy work be undertaken to consider what further safeguards might be introduced to militate against this risk and other risks to policy effectiveness.

Recommendations

The following recommendations are proposed based on the evaluation findings.

a) Further policy work :

- To consider how NAP can be made part of a more holistic approach to dealing with insolvency, whereby all viable options are considered and encouraged in debt situations, including SIO, NAP, or repayment.

[3] Estimate based on 2009/10 data. Savings would be less than this for previous years where fewer numbers of NAP applications were made.
[4] Based on 2009/10 data. Caveats apply. See Chapter 5 for further detail.

- To consider the benefits of introducing budgeting skills through identifying proven, suitable approaches for debtors, where appropriate. The options for promulgating good budgeting practices both to the community-cohorts concerned and as part of the NAP and other insolvency procedures could be considered.

- To consider and promote further the role of budgetary advisers and community-based organisations in helping debtors to adopt long-term, responsible financial behaviours.

- To consider how to militate against the unintended consequences of the NAP legislation outlined in this evaluation, including administration costs to creditors and unreasonable write-offs of debts.

- To consider how to provide better safeguards against possible misuse of NAP by debtors in dealing with their debts through the scheme.

- To consider guidelines and regulation of financial institutions to discourage credit in certain clearly defined situations where there is a high probability that it will lead to unsustainable indebtedness.

- To consider changes to operational processes that would assist creditors in managing compliance costs created by NAP legislation (e.g. through more transparent notification to creditors of debtors' assets).

- To consider consulting with insolvency advice providers, particularly the Citizens' Advice Bureau, on changes to NAP processes that would further help users (e.g. user-friendly application form).

b) Further evaluative work

- To estimate the full costs and benefits of the insolvency legislation six years after NAP was introduced, to a) achieve a more accurate assessment of net benefits, b) determine if costs are higher than estimated, and, c) complete an assessment beyond that possible with the limited information available in the NAP evaluation.

Contents

1. Introduction

1.1 Scope and evaluation questions

This evaluation considered the following key questions:

- Has the NAP had a positive impact on programme participants' economic and social outcomes?
- Is the NAP reaching sufficient numbers of, and eligible, participants?
- Is the programme administered well?
- Is the NAP more cost-effective to government than other routes, such as bankruptcy or summary instalment orders?

The following lines of inquiry were out of scope for this evaluation:

- Analysis of cross-government administrative data
- A full cost-benefit analysis of the legislation
- International comparisons.

The evaluation findings indicate that there is significant value in further evaluative work in some of the above areas.

1.2 Methodology

The evaluation was limited by some practical constraints in the early stages, resulting in some changes from the evaluation plan. Our final methodology consisted of:

- A survey of NAP debtors;
- A survey of budget advisors;
- Focus groups with budget advisors;
- Selective interviews with creditors, banks and financial institutions;
- Selective interviews with stakeholders;
- A case study of debtors who have not gone through NAP; and
- Analysis of administrative data from the Insolvency and Trustee Service.

1.3 Policy context and intervention rationale

Outline of the No Asset Procedure

The No Asset Procedure (NAP) was introduced in December 2007 as a means to assist people who have no available assets or insufficient income to repay debts up to around $40,000 without entering bankruptcy. The programme has assisted around 7,000 people since implementation, and the cost to government for administering the programme is estimated at around $2 million each year.

Debtors who are unable to pay their debts may have an alternative to bankruptcy through the NAP. Unlike bankruptcy, the NAP lasts one (1) year. The period of a NAP can be extended by up to 25 working days if a creditor objects to a debtor's NAP. The Official Assignee (i.e. the state financial administrator of insolvency) will write to the debtor to confirm if the period of their NAP is to be extended. The Official Assignee will also contact the debtor to confirm the outcome of the objection process.

Creditors cannot pursue NAP participants for debts included in the NAP. When a debtor enters a No Asset Procedure, their debts are frozen on the date of entry, and the debtor is released from those debts on discharge. A record of a debtor's entry to a NAP will remain on the Insolvency and Trustee Service website for four (4) years after discharge.

Applications are made to the Official Assignee, either electronically or manually. An application and Statement of Affairs (SOA) must be completed to a standard acceptable to the Official Assignee.

To qualify for entry, participants must:

- have no realisable assets (realisable assets exclude cash up to $NZ1,000, a motor vehicle up to $NZ5,000, tools of trade, and personal and household effects);
- not previously been admitted to the no asset procedure;
- not previously been adjudicated bankrupt (except for overseas bankruptcy);
- have total debts (excluding student loan) not less than $NZ1,000 and not more than $NZ40,000; and
- complete a means test showing no means of repaying any amount towards the debts.

The Official Assignee can refuse entry into the NAP if:

- creditor(s) object to entry; or
- bankruptcy proceedings have been initiated and the likely outcome for the creditor would be materially better if the proceeding continued; or
- assets have been concealed; or
- an act has been committed that would be an offence under the Insolvency Act 2006 if bankruptcy applied; or
- debts were incurred knowingly without means to pay them.

Applications for NAP have increased each year since its introduction (see Table 1 and Figure 1). Applications for bankruptcy and Summary Instalment Orders (SIO), where debts are repaid according to means) have also been increasing each year, possibly reflecting changes in the economy and increased numbers of insolvency.

Table 1: Numbers of accepted and rejected insolvency applications

	NAP		Bankruptcy		Summary Instalment Order	
Year	Accepted	Rejected	Accepted	Rejected	Accepted	Rejected
2007/08	1244	383	671	131	54	117
2008/09	2833	1432	1656	465	257	184
2009/10	3026	1341	2024	375	346	106

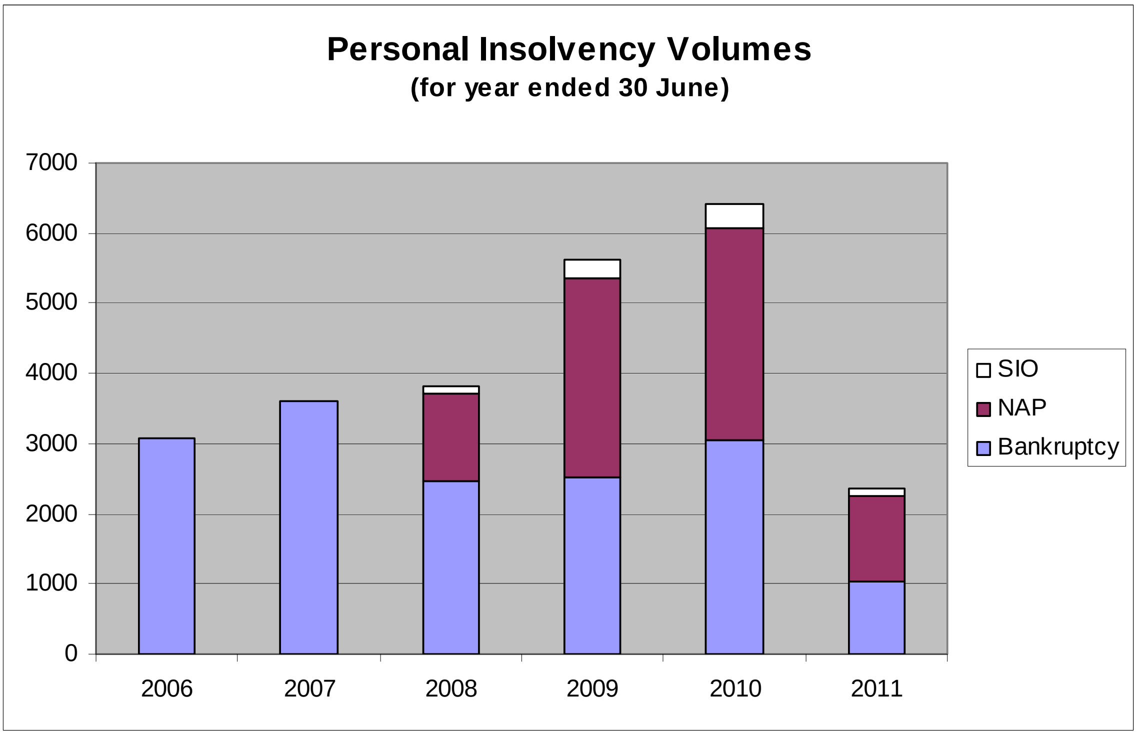


Figure 1: showing insolvency volumes since 2006 (Source: ITS data and analysis up to the mid-point of 2010/11)

Funding to administer the NAP is estimated at a total of $2 million each year.

Policy context and objectives

The original objectives of the programme, stated in Cabinet Paper EDC (02) 90 were:

a) to acknowledge that the debtor usually cannot avoid bankruptcy and therefore the punitive and deterrent aspects of the current regime are inappropriate and have limited relevance

b) to give the debtor the opportunity of a fresh start

c) to provide appropriate safeguards against risk of abuse; and

d) to provide a simple procedure that minimises administration costs to the state.

The policy was introduced after review of the insolvency law, due to changes in the types of debtors applying for bankruptcy. Cabinet Paper EDC (02) 90 outlines that an increasing number of bankrupts were ‘consumer bankrupts’, consisting of a high number of beneficiaries, on low incomes, with a pool of debt comprising utilities debts, IRD debt, credit card debt and loans from finance companies or banks.

Research suggested that these debtors can become insolvent because of factors largely outside of their control; there was often very limited action they could take to avoid bankruptcy; and they had very limited ability to repay debt. Accordingly, the punitive restrictions of bankruptcy designed to deter individuals from becoming insolvent are considered to be not relevant to this sub-group of bankrupts.

The No Asset Procedure was introduced to provide an alternative to bankruptcy with conditions that had more relevance to the ‘consumer bankrupts’. For example, many of the conditions of bankruptcy, such as restrictions on being in business or travelling overseas, appeared to be of little relevance to these bankrupts.

There is also little incentive for bankrupts to better their financial situation during the term of bankruptcy as any property acquired after that, including wages, are vested in the Official Assignee. Combined with the social and financial stigma of being bankrupt, this was perceived to lead to lowered self-esteem and productivity. An aim of the NAP was to provide these bankrupts with the incentive and opportunity to more quickly become productive members of the economy.

As well as being an alternative for debtors who would otherwise become bankrupt, the Cabinet Paper notes that the procedure was anticipated to attract also a class of debtors who are insolvent in a technical sense but do not usually become bankrupt. This suggests the type of debtor who might otherwise manage their outgoings and debts through other means, such as loans from finance companies or banks, until some ‘life event’ occurs that interferes with their ability to meet their obligations. These individuals may then be required to be administered by the state through bankruptcy routes.

Intervention rationale

The intervention logic is based on the problem definition, outputs and policy objectives found in Cabinet Paper EDC (02) 90, as well as evaluative observations and assumptions. The latter are distinguished in the logic diagram by solid or dashed lines respectively.

The problem definition as set out in the cabinet paper is:

- there have been an increasing number of consumer debtors over the decades;
- existing insolvency rules do not cater well for consumer debtors with few assets and low incomes who cannot repay debts;
- punitive aspects of bankruptcy are less applicable to consumer debtors;
- bankruptcy and other insolvency routes are costly and lengthy for the state to administer;
- bankruptcy is perceived to lead to lower self-esteem and productivity due to the stigma and restrictions involved.

The policy's objectives were twofold.

Firstly, it aimed to provide an insolvency route that would not subject consumer debtors to the same punitive consequences as bankruptcy, whilst ensuring that safeguards were in place to prevent misuse of the procedure. This was intended to lead to debtors recovering faster from insolvency and, ultimately, contributing more productively within society and the economy.

Secondly, the policy aimed to reduce the on-going administrative burden to the state, leading to increased efficiencies and savings.

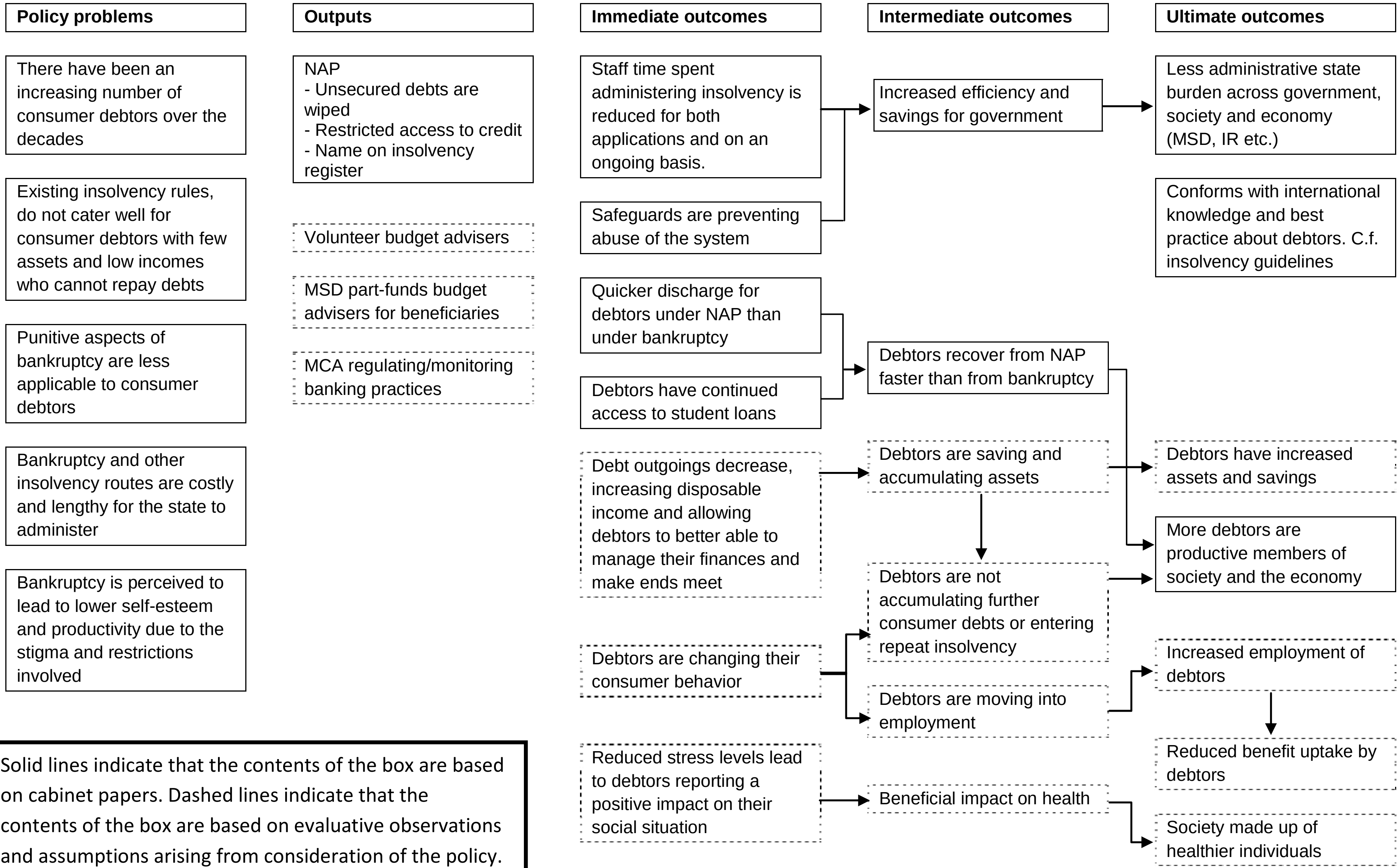
The policy is having some impacts that were not explicitly mentioned in cabinet papers.

Some individuals appear to be changing their credit-fuelled consumption behaviour and this, along with a higher disposable income allows individuals to save more and reduces dependence on benefits and the likelihood of repeated insolvency. Reduced stress levels following the procedure also appear to have a positive impact on debtors' health outcomes.

Debtors are in the NAP for one year. At the time of the evaluation at the beginning of 2010, the first NAP debtors to go through the procedure (which began at the end of 2007) had therefore only been out of the scheme for a little over two years. Two years is not a sufficient length of time to allow the full impacts on debtors' intermediate and ultimate outcomes to be observable.

In terms of outcomes for the state, the impacts of the procedure are easier to measure due to the quantitative data available. Again, however, the short time-lapse between the introduction of the policy and the evaluation means that trends cannot be fully observed and it is difficult to separate the impact of the policy from the impact of other events such as the global financial crisis.

Intervention logic diagram



Solid lines indicate that the contents of the box are based on cabinet papers. Dashed lines indicate that the contents of the box are based on evaluative observations and assumptions arising from consideration of the policy.

2. Findings: Has the NAP had a positive impact on debtors' economic and social outcomes?

2.1 Demographics of NAP debtors

NAP applicants have a considerably higher unemployment rate than other types of insolvents and a greater percentage of them are on benefits (see Figure 2).

A higher proportion of NAP participants are female (similar for SIO insolvencies), than compared to bankruptcy. For example, around 43% of bankruptcies in 2010 were female, compared to 55% female for NAP and 60% female for SIO.

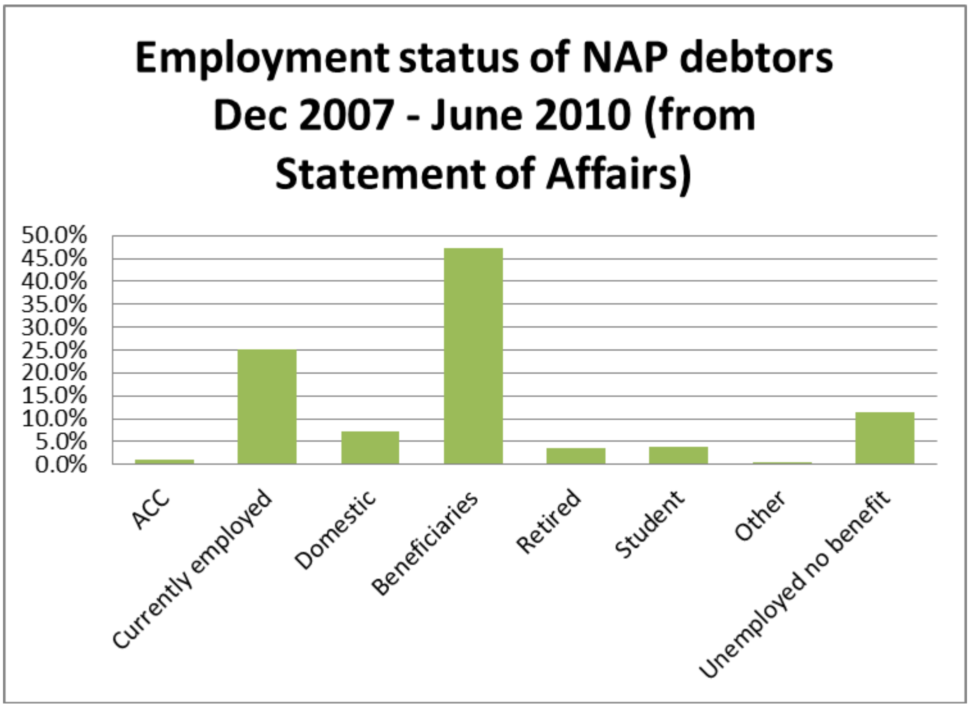


Figure 2: showing the Employment Status of NAP debtors (Source: ITS data from Statements of Affairs)

Accepted NAP applicants are concentrated at lower income levels while other types of insolvents are more evenly spread. NAP and SIO debtors have, on average, much lower levels of debt than other insolvent persons. NAP applicants are means tested for income and must have less than $40,000 of debt.

The average level of debt for NAP debtors, since inception of the policy in 2007, currently stands at $21,182[5].

Auckland and Christchurch contain the largest numbers of applicants. Christchurch, Hamilton, Napier and Rotorua are overrepresented for their size.

[5] Average debt level based on average of all NAP estates 1 December 2007 to 30 June 2010.

New Zealand Europeans are the largest ethnic group involved in NAP applications, followed by Maori although a higher percentage of Maori enter the NAP compared to Europeans. Low numbers of Pacific Islanders enter the NAP which is unusual given the high representation of this group in arrangements with fringe lending companies.

Budget advisers interviewed for the evaluation considered that their NAP clients tended to be from a mix of low and medium socio-economic groups. They had split views regarding whether this mix has changed over the years. Some thought that the economic recession has played a part in increasing the numbers of NAP debtors in medium socio-economic groups or that consumer debt levels in these groups are getting out of control. Others commented that their clients are largely beneficiaries who struggle to make ends meet and accumulate debt as a result.

Ministry of Social Development (MSD) data confirm that 53% of NAP debtors since 2007 have been beneficiaries.

Budget advisers stated in focus groups that different age categories are associated with different reasons for becoming insolvent. Young NAP debtors tend to have no budgeting skills and problems with credit. Debtors in their 30s to 40s tend to have accumulated debts through poor budgeting and overspending. Older debtors tend to have reached a crisis point in their life such as a marriage breakup or job redundancy.

Some evidence across the evaluation suggests that NAP debtors tend to have low literacy levels. We discuss the implications of this in Chapter 3.

Survey of NAP debtors

Ideally we would have conducted administrative data analysis as part of the assessment of the NAP's impact on debtors' economic and social outcomes, but for various reasons this was not possible. Instead, an online survey of NAP debtors was completed. The survey was designed with the demographics of the NAP population in mind. All NAP debtors between 2007 and June 2010 who provided an email address to ITS were surveyed[6].

The demographics of survey respondents differ slightly from those of the NAP population as a whole. The survey respondents consisted of a considerably higher percentage of employed individuals and students than the whole NAP population (35.8% and 7.6% respectively for the survey as opposed to 25.3% and 3.8% for the NAP population), and a considerably lower percentage of beneficiaries (38.5% as opposed to 47.3%[7]) and unemployed individuals. The survey also has a higher percentage of Europeans than the population (69.1% as opposed to 61.6%) and a lower percentage of Maori (17.4% as opposed to 26.2%).

[6] The survey was sent only to those who gave email addresses in their Statement of Affairs, and respondents are those who still have internet access – i.e. they had internet access for at least six months and up to three and a half years after their NAP application, depending on when they applied.

[7] Note that ITS data shows that 47.3% of NAP debtors are beneficiaries, whereas MSD data currently shows 53%. This difference is likely due to differences in cut-off dates for counting total numbers of NAP debtors. The difference may also be accounted for by some NAP debtors being unaware that their benefit status should have been declared in the Statement of Affairs.

1,022 respondents completed the survey, which is a 34.7 per cent response rate. While this is a relatively low response rate, we believe the sheer number of respondents overrides this.

The choice of email addresses for the survey frame limited the coverage of the survey. Also, the demographic characteristics of the survey respondents reflected the limited coverage with evident skew in the respondent population compared with the overall NAP population. Consequently, some caution is required with respect to the survey findings. However, the survey results are consistent with other evidence gleaned in the evaluation and, while not wholly representative, are likely to be valid for the sub-group who responded and, to a lesser extent, all NAP users.

The demographics of the NAP population should be borne in mind, therefore, when considering the survey's results, as should the survey's difference from the population's demographics. The survey results potentially show a more positive result than may be actual for the whole NAP population.

2.2 NAP has been mostly positive for debtors' social and economic outcomes

We found an overwhelming body of evidence across the evaluation that NAP has been beneficial for many genuine situations where mistakes or life-events have led to an unmanageable debt situation. NAP has facilitated a fresh start for individuals in such situations.

The majority of respondents in the survey of NAP debtors stated that they now find it easier to manage their household finances (72%) and that they were either saving or their income covered what they spent; 27 per cent stated that they were only just making ends meet and less than two per cent that their debt was continuing to grow. Given the economic situation of NAP debtors, this is an encouraging response.

The majority of respondents reported that the NAP has had a positive impact on their financial position, standard of living and, for some, income (see Figure 3). This is supported by the fact that around 80 per cent of the comments received from debtors were positive (See Box I).

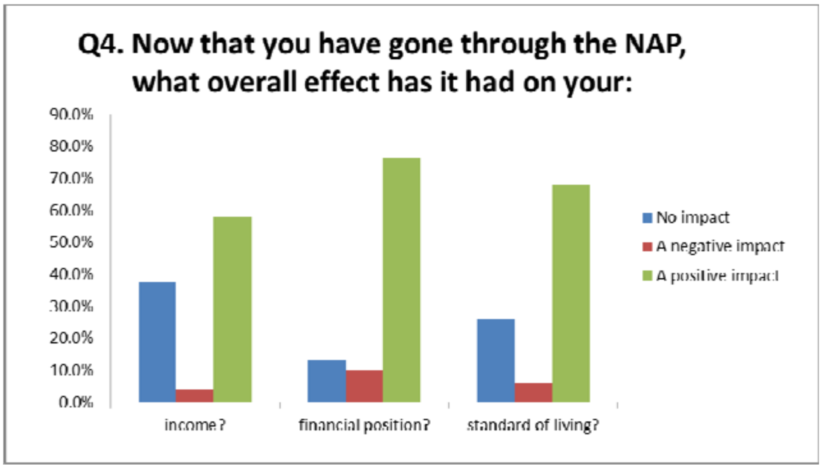


Figure 3: showing the positive impact of NAP on debtors' economic outcomes

The reported positive impact on income does not necessarily imply that unemployed NAP debtors have moved into jobs. The majority of respondents also reported no impact or an unknown impact on their ability to find a job, suggesting that actual incomes may have remained fairly static while disposable incomes increased due to the effect of having their debt repayment obligations wiped out.

NAP debtors surveyed do not appear to be falling back into debt; 56 per cent of respondents said that they currently have no debt and a further 36 per cent said that they have debts between $1-$10,000. The existence of some debt does not necessarily mean that the debtor has accumulated it after the NAP because secured debts and student loans are not covered by the procedure. The debt levels of the 2007 to 2008 cohort of debtors are as positive as for the more recent debtors, suggesting that there is not a substantial deterioration following the NAP.

However, when beneficiaries are singled out, evidence from the survey and data from the MSD show that many of them are continuing to accumulate debts with MSD. This is discussed in more detail in section 2.4 below.

One of the key reasons for low debt levels is the difficulty that NAP debtors face in obtaining credit. Lending institutions are unwilling to give credit to individuals who are listed on the insolvency register.

The majority of survey respondents reported a positive impact on health although a quarter stated that there was no impact. The positive impact on relationships is not as great, with a little over half reporting a positive impact and just under 40 per cent reporting no impact.

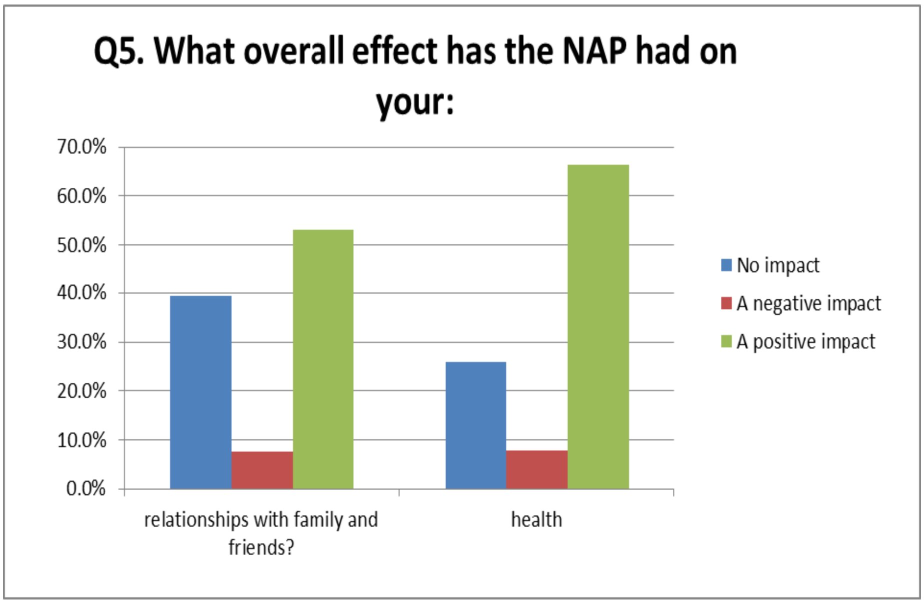


Figure 4 showing the positive impact of NAP on debtors' social outcomes

From the comments received, these positive social impacts seem to be primarily due to the alleviation of stress (see Box I). Other comments indicate that a greater disposable income means that debtors can lead healthier lifestyles and that the NAP was a factor in preventing a small number of debtors from committing suicide. At one of the focus groups budget advisers commented that around 10 to 15 percent of NAP debtors make comments about suicide.

Box I: Positive comments on debtors' economic and social outcomes

> *"The No-Asset Procedure is a wonderful tool, and has massively impacted my life in a positive way."*
>
> *"I felt that the NAP was a lifesaver for myself and my family, as the stress of years of paying of[f] debt and working 3-4 jobs at one time was destroying my health, and my family was suffering.*
>
> *"[NAP] completely change[d] my life. Stress free and able to eat better meals rather than offal meats and cheap meats etc or going without which was affecting my health"*

The NAP has had a self-reported positive impact on most survey participants' social and economic outcomes, as shown in their financial position, disposable income, standard of living, debt levels, relationships and health.

These findings correspond with findings across the evaluation that NAP has facilitated a fresh start for many debtors. For example, our survey of budget advisors found that 62% of budget advisors think so, while 33.8% consider that it depends upon the situation. No budget advisors answered 'not really' to this question, suggesting that they clearly perceive NAP to have led to positive outcomes for debtors. However, the survey suggested that NAP had better facilitated a positive impact on debtors' personal and social outcomes, rather than their economic outcomes.

2.3 NAP has resulted in some negative consequences for debtors' outcomes

Some of the debtors surveyed reported that the NAP has had a negative impact on their economic outcomes. The comments section of the survey showed that these are due to (1) NAP debtors' inability to obtain new credit, (2) some debtors losing their jobs or not being able to find work because of having gone through the NAP and, (3) some landlords refusing to accept NAP debtors as tenants.

44 per cent of respondents who began the NAP between July 2008 and June 2010 said that it was now harder to obtain credit and 47 per cent said that they didn't know[8] (Figure 5 below).

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[8] These figures are for 2008-2010 rather than 2007-2010 because we added a "don't know" category to this question after we had sent the survey to the first year group of NAP debtors. This was in response to comments from debtors that they were unable to answer the question properly.

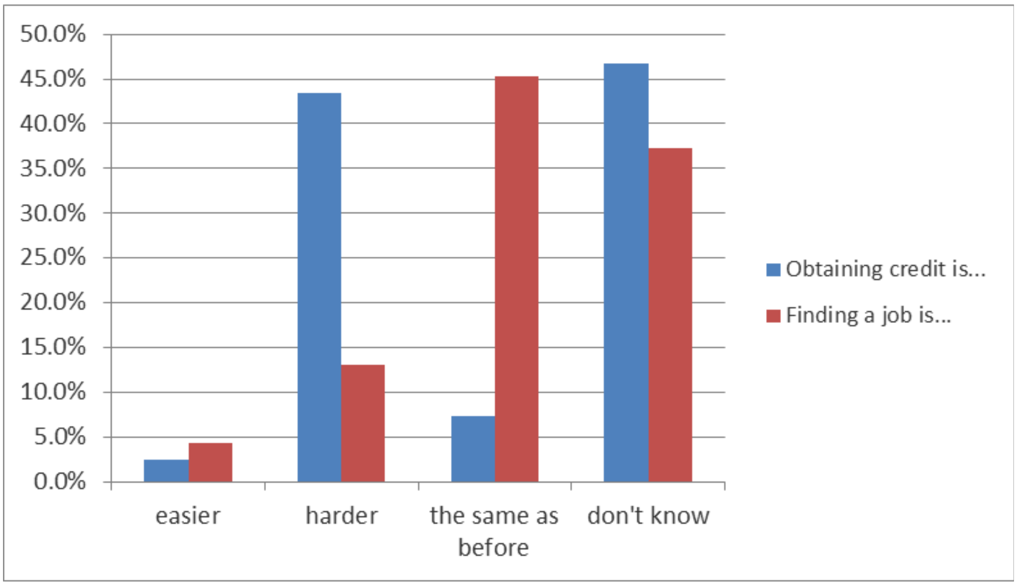

Figure 5 showing that NAP users either find obtaining credit harder or they don't know

This difficulty in obtaining credit is the most commonly reported negative consequence of the NAP. The difficulty arises because NAP debtors' names are publicised in the insolvency register on the Insolvency and Trustee Service's website. Lending institutions are then unwilling to give them credit. From the comments received, the implications of this include being unable to find money to pay for unexpected events or household items and restrictions on their ability to have a phone and other account based services.

There were also a small percentage of debtors who reported that the NAP had a negative impact on their social outcomes. From the comments received this appears to be for two reasons: (1) those debtors on whom the NAP had a negative economic impact had a consequent increase in stress and strained relationships and (2) those debtors who object to being 'named and shamed' on the internet.

Many respondents are entering the NAP without understanding its credit ramifications. This comes through strongly in the comments section where around 20 percent of the comments were to do with the credit and/or banking implications of the NAP (see Box II) and is supported by comments from budget advisers at the focus groups, who particularly noted that not having access to a credit card makes it hard to conduct online payments, such as utility bill payments

Even those who reported in comments that the NAP has, overall, been positive for them, often stated that they were unaware of the extent to which it would be difficult to obtain credit.

Box II: Many debtors are entering the NAP without understanding its ramifications

> *"I did not know that my bank account would be closed…"*
>
> *"I still have no idea what happens when I finish my NAP"*
>
> *"[T]he only problem I have with it, and didn't know this would be the case, is that I now have bad credit for 5 years. which I thought was only for the year I was in it."*
>
> *"I was under the impression when I signed up that I would have a clean slate in terms of my financial credit however this has not been the case… I regret that I have had my credit abilities so affected, and possibly would have reconsidered using this procedure if I had been fully aware of its implications."*

This lack of understanding regarding NAP ramifications is interesting because all the necessary information regarding the credit implications of the NAP is contained on the ITS website. Debtors do not appear to be utilising this information. However, evidence indicates that NAP applicants may have difficulty understanding the information provided since many debtors have low literacy levels, including financial literacy.

Psycho-social problems are another reason why some debtors appear not to understand the procedure. This was a point that was brought out at the focus groups, where budget advisers commented that such debtors are likely to disregard the punitive aspects of the procedure.

In summary, a minority of debtors surveyed reported that the NAP had a negative impact on their social and economic outcomes. These negative impacts appear to be primarily due to the implications of having their name published on the insolvency register and especially the credit restrictions that this imposes on the debtor. Many debtors did not fully understand the ramifications of the procedure when they entered the scheme.

2.4 Findings across the evaluation are mixed on whether debtors' spending behaviours are changing

We would expect to see that debtors' spending behaviours change, and that they are now better managing their finances. If this does not occur, the logic required to reach final outcomes of the policy, including that individuals are more able to be productive members of society and the economy, will be not achieved in the long-run.

There are some indications from the NAP debtor's survey that some spending behaviours are changing. Evidence for this comes from debtors' responses regarding the managing of their finances, what their current debt levels are, the impact of budget advisers and the voluntary comments made (however, see the discussion below Box III).

The majority of respondents (72%) stated that it is now easier to manage their household finances and that they are either saving (20%) or that their income at least covers what they spend (52%). This can be contrasted with debtors' situations before NAP, when their debts continued accumulating until they were insolvent

Less than two per cent of survey respondents said that their debt was continuing to grow after the NAP.

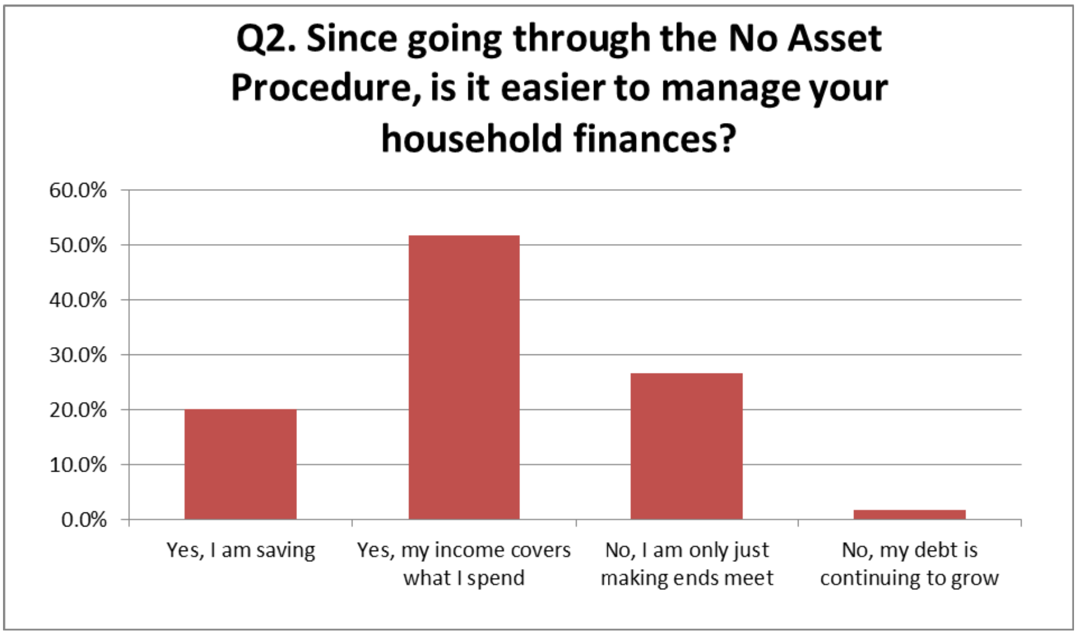

Figure 6 showing NAP users report that it is easier to manage their household finances

This picture of debtors finding it easier to manage their household finances seems to be constant over time – there is very little difference between the various year groups of NAP debtors surveyed. This suggests that changes in spending behaviour may have become habitual.

As mentioned in section 2.2, debtors do not appear to be falling back into debt. This also appears to be constant over time – there is no obvious relationship between current debt level and the year that respondents went through the NAP. If NAP debtors were accumulating more debts we would expect to see such a relationship.

47 percent of respondents who went through the NAP between 2008 and 2010 didn't know whether it was now harder or not to obtain credit. A possible explanation for this is that they have not attempted to do so. If this is the case then it may be another indication of a change in behaviour from a lifestyle fuelled by credit to one without it.

Possibly the best indication of changed financial behaviour comes through from the comments received. Over a quarter of the comments specifically noted or demonstrated that debtors had changed their financial behaviour subsequent to the NAP and many of these directly attributed the change to the NAP. Some emphasize that being unable to obtain credit was useful in developing good budgeting habits. Others state that although the NAP didn't teach them financial skills as such, it gave them the opportunity for a clean break that allowed them to implement the lessons that they had learnt through past mistakes (see Box III).

Box III: Debtors' comments indicate changes in spending behaviour

> *"It is an incentive that you cannot have credit...those things you want/need is just about saving your money and doing it the right way."*
>
> *"I certainly have learnt a valuable lesson in living within my means and am going to keep it this way."*
>
> *"I do believe the no asset procedure helped me to… this time take responsibility for all my actions and make responsible decisions."*
>
> *"It's great when you have tried for years to sort your budget out but it ends up getting worse as playing catch up never works. NAP definitely helped me and I found it gave me a fresh start and has prevented [me] from getting into debt again"*

The number of voluntary comments along these lines and the suggestive evidence from the survey results suggest that NAP is resulting in changes in spending behaviour for some individuals.

However, it should be noted that these are self-reported findings and not observed or necessarily actual behaviour. There are a number of methodological phenomena, including social desirability bias, whereby individuals are more inclined to report that their behaviour corresponds positively with the expectations of the study or questions in discussion. In these cases, actual or observed behaviour is often known to differ from the self-reported behaviour. The findings from our survey of NAP debtors therefore need to be compared with evidence from other parts of the evaluation.

Data on beneficiaries provided by the MSD shows that 53% of NAP debtors between December 2007 and March 2011 were beneficiaries at the time of adjudication. Of these, nearly half received Recoverable Assistance[9] from MSD within their 12 month NAP period. Essentially this means that they have accumulated further debt after entering the NAP. This would seem to indicate that these debtors haven't substantially changed their behaviour[10].

When beneficiaries are singled out of the survey of NAP debtors (28% of respondents), their responses reflect this finding. Compared to other respondents, fewer beneficiaries reported that they were saving and more reported that they were only just making ends meet. Beneficiaries also reported higher debt levels than other respondents.

Of those respondents who used a budget adviser during the NAP (39%), nearly three quarters of them said that the adviser had helped to improve their financial management skills.

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[9] Recoverable Assistance is an interest free loan to help beneficiaries and people on low incomes meet immediate and essential needs. People can borrow up to six weeks' worth of their benefit and the money has to be repaid.

[10] Alternatively, the finding regarding beneficiaries accumulating further debt may be linked to benefit levels. That is, in some cases, benefit levels may be set too low. This aspect is beyond the scope of the evaluation, however.

Budget advisors are mixed on whether they think that the NAP is helping people in genuine situations (47.9% of respondents to the budget advisers' survey), or encouraging a 'get-out' of financially irresponsible behaviour (46.5% of respondents). Our interviews across the rest of the evaluation, including with banks, creditors and financial institutions, and focus groups with budget advisors corroborated this concern that there are a number of cases where the NAP is not providing sufficient incentives to change behaviour.

For instance, budget advisers commented that NAP debtors can still obtain credit from informal lending institutions such as instant finance companies or local medical practitioners, who do not necessarily conduct credit checks or income verification. This suggests that there are risks that some debtors have not changed their behaviour.

This concern about the NAP not providing sufficient incentives to change behaviour is reinforced by the data on beneficiaries from MSD. Beneficiaries who owed balances to MSD when they entered the NAP were more likely to accrue Recoverable Assistance debts (64% accrued Recoverable Assistance payments during their NAP period) than those who didn't originally owe MSD anything (27% accrued Recoverable Assistance payments during their NAP period). This suggests that the NAP may not be changing the behaviour of debtors who obtain Recoverable Assistance.

The evidence suggests that the NAP is better at changing some debtors' behaviours than others[11]. Beneficiaries in particular appear to be continuing to accumulate debt.

We discuss later in this report a view that other insolvency routes, including bankruptcy and SIO, better encourage change in debtors' behaviour.

2.5 Budgeting skills should be considered for NAP

We received calls across all of our evidence streams that budgeting skills should be introduced as a condition of NAP, for two main reasons. First, as a result of concerns over those NAP debtors for whom NAP does not encourage changed behaviour, and second to provide further safeguards against the risk of gaming. Our findings on the extent of gaming with respect to NAP are discussed in Chapter 4.

We found some concerns across the different evidence sources for the evaluation that the problem of financial mismanagement and budgeting is becoming a deep cultural problem. We received calls for better financial education at schools, and a societal expectation that individuals should be expected to better manage their finances within their means, rather than 'buying now and paying later'.

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[11] Justin Strang, Social Policy Agency, MSD (2006) concludes, 'The results of budget advice service evaluation point to significant advantages in assisting people on an individual basis. However, outstanding issues remain, such as the effectiveness of budget services for all people on low incomes, especially long-term benefit recipients'

Interestingly, a lack of financial skills when younger was one of the things that debtors attributed their own insolvency to in the survey. There were around 20 comments along these lines.

Some NAP debtors themselves commented that budgeting advice should be a condition of the NAP (see Box IV). As mentioned above, of those respondents who used a budget adviser during the NAP (39%), nearly three quarters of them said that the adviser had helped improve their financial management skills.

Box IV: Some NAP debtors themselves suggested more budget advice

"If it was compulsory to work with a budget advisor… [the NAP] would be more beneficial on an ongoing basis"

"Where I think it could be improved is follow up for the client… compulsory education around either budgeting or learning how to make your money grow. In my experience a lot of people know how to… budget, that is not the issue, the issue [is] instant cash traps, people not understanding or knowing how to climb out of poverty."

"I think… [NAP] is great. But I think if I had learned how to budget in the first place I would not have needed one in the first place. I think people should be TAUGHT in school how to budget, how to REALLY survive once they leave the comforts of living with their parents. I had no knowledge of budgeting etc until AFTER I had to apply for an NAP."

Suggestions across the evaluation for introducing budgeting skills as a condition of NAP included:

- Financial literacy and budgeting skills should be an integral part of the procedure to ensure that better financial choices are made in the future;
- Visiting a budget advisor should be a condition of applying for NAP;
- Visiting a budget advisor 6 months prior to an application being accepted should be a condition of NAP, to assess whether repayment is an option;
- Follow-up with a budget advisor should be a requirement after exiting NAP.

However, we also received some concerns that there are complications with introducing budgeting skills as a condition of NAP. These included:

- Providing conditional budget counselling as a part of NAP would not be appropriate in all situations, especially in 'no fault' insolvency situations (i.e. where unexpected life-events lead to indebtedness);
- Providing budgeting skills for NAP debtors would be expensive and resource intensive;

- Provision of budgeting skills for all debtors (either NAP or otherwise) is currently administered by voluntary organisations (who may or may not receive some funding from other parts of government), whose resources are already stretched;

- A view that budgeting skills should remain a voluntary choice (28.6% of budget advisors surveyed believe so); and

- Concerns over whether including budgeting skills as a condition of NAP, at some expense to the state, would lead to changed behaviour.

As noted earlier, our findings from our survey of NAP debtors indicated that of those who had used a budget advisor (39%), nearly three quarters said that the advisor had helped to improve their financial management skills. This finding corresponds with earlier research on the effectiveness of budget advisory services in better enabling debtors to manage their finances within their means.[12].

Canada's insolvency procedures currently include budgeting skills as a condition of undergoing insolvency. Their insolvency services are currently conducting a worldwide evaluation of financial counselling that is attached to insolvency procedures. We recommend that the results of their evaluation are considered further by policy teams to examine the likely effectiveness of introducing budgeting skills as a condition of NAP.

As part of our evaluation, we discussed with Canada's insolvency service the extent to which financial counselling has been found to be effective. Evidence suggests that those debtors who have undertaken financial counselling have been positive about its effectiveness. Anecdotal evidence from some interviews suggests that for those for whom insolvency has been a result of mismanagement of funds, financial counselling is beneficial; but for those for whom a life-event, such as redundancy, has led to insolvency, financial counselling is less likely to be beneficial.

Longitudinal analysis is currently underway to examine any change in long-term behaviour trends.

A difference of note with Canada's system is that creditors contribute a proportion of repaid debts towards payment for providing financial counselling to debtors. The possibility of adopting this practice in New Zealand should be given further consideration, particularly considering creditors' concerns discussed later in this report.

We recommend that policy teams give further consideration to introducing budgeting skills as a condition of NAP, where appropriate. International best practice guidelines suggest that this can be beneficial[13].

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[12] *Budgeting Assistance and Low Income Families: a survey of patterns of income and expenditure of New Zealand Federation of Family Budgeting Service Clients*, Wilson, Houghton and Piper, Social Policy Agency, 1995

[13] INSOL International Consumer Debt Report: Report of Findings and Recommendations, *INSOL International*, May 2001

3. Findings: Is the NAP reaching everyone it should?

3.1 Mixed findings on whether there is sufficient awareness of NAP

The evaluation found different views across the evaluation on whether there is sufficient awareness of NAP. Most (70%) of the NAP debtors we surveyed said that NAP was easy to find out about after being alerted to its existence. Only a minority of respondents (16%) replied that NAP was either moderately hard or hard to find out about (see figure 6).

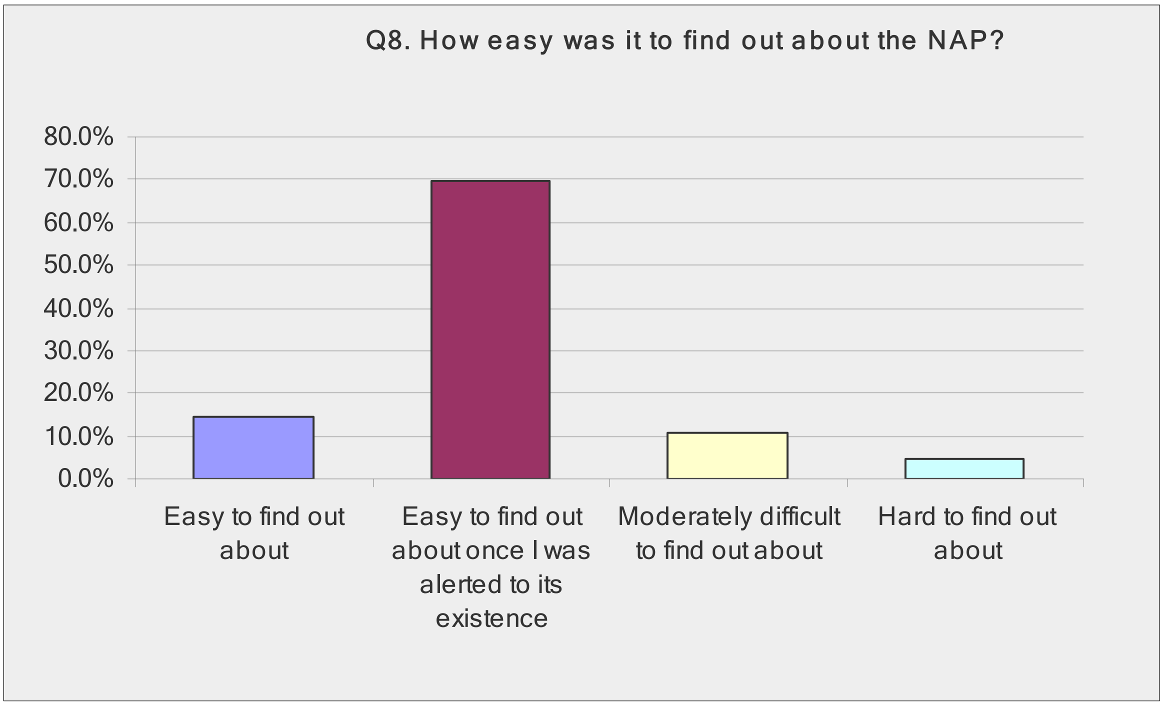

Figure 6 showing that most NAP debtors surveyed said that NAP was easy to find out about after being altered to its existence

The most common way of finding out about NAP for the debtors we surveyed was through word of mouth. The Internet, followed by Citizens Advice Bureau and the New Zealand Federation of Family Budgeting Services were the next most common routes.

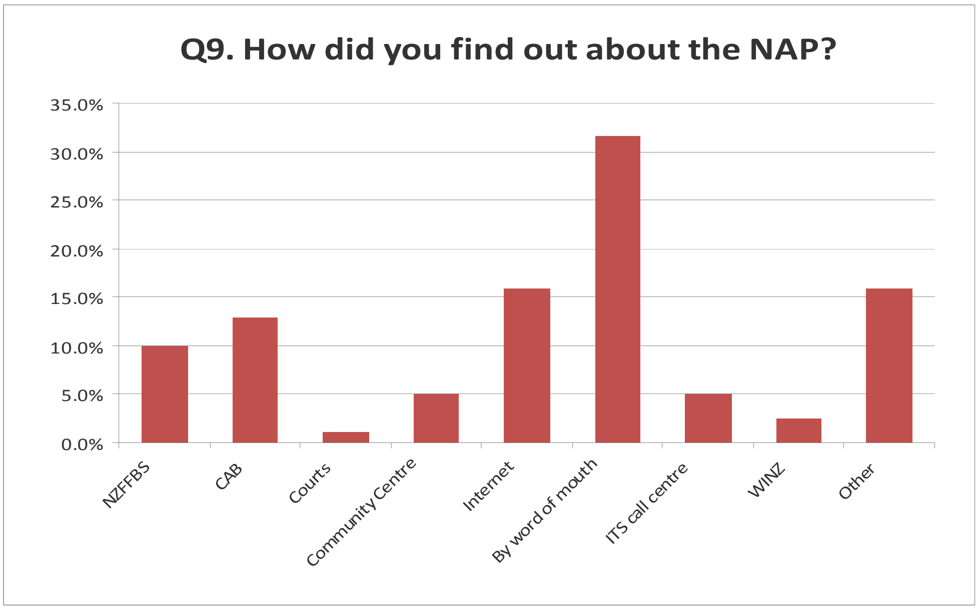

Figure 7 showing that word-of-mouth was the most common way of finding out about NAP

Other evidence sources across the evaluation suggested that awareness of NAP can be limited. In our survey of budget advisors, budget advisors gave mixed responses on debtors' awareness of NAP prior to visiting them: 41% consider that debtors had no knowledge of NAP, whereas 59% overall considered NAP debtors to have some awareness of NAP (either through another organisation, through their initiative, or a good awareness already).

Focus groups with budget advisors, particularly in the Auckland area, considered that most debtors visiting budget advisors offices are not aware of the procedure, and called for greater promotion and publicity of the procedure.

However, budget advisors are divided on the extent to which more should be done to raise awareness of NAP or insolvency options: 38.5% believe that awareness should definitely be increased, whereas 44.9% thought that this was possible but not essential; 9% considered that there is enough awareness.

Concerns across the evaluation around raising awareness of NAP include a view that awareness raising would lead to NAP being used as an easy exit from financial responsibilities, while others considered that there are people who are not sufficiently aware of NAP as an option, particularly due to literacy and language issues (discussed further below).

Evidence from our focus groups calls strongly for raising awareness, but caveats remain around the extra resource that this would require from volunteer budget advisors from increased numbers of debtors seeking assistance.

An analysis of discussion threads on forums such as Trade Me shows confusion among debtors over the appropriate insolvency routes available to them to deal with their difficult financial situation. The information passed between debtors on these forums is also sometimes inaccurate, and contradicts accurate official information publicised on the ITS website.

The discrepancy between publicly available information on the ITS website, and debtors' confusion in these forums over appropriate insolvency routes, raises questions over why debtors are not more adept at seeking out the relevant publicly available information for their needs.

Feedback from our focus groups indicates a number of possible reasons. First, debtors who have reached the point of an unmanageable financial situation are often dealing with difficult life challenges, which affect their psychological well-being, their cognitive functioning skills, and their ability to process information effectively. Second, many NAP debtors have low literacy and financial literacy skills.

This confusion among debtors supports evidence from other parts of our evaluation that there are some questions over whether there may be a need for raising awareness of NAP.

However, any policy decisions on raising awareness would need to consider the legitimate concerns over doing so noted above. In addition, given findings from the NAP debtors survey that 70% of respondents considered that NAP was easy to find out about once alerted to its existence, the answer to this issue, and the appropriate policy intervention, is not clear cut. Further work and analysis on the appropriate policy intervention would be needed.

3.2 There are some groups that are less well assisted by NAP

The evaluation found that NAP caters better for some groups of people, and less for others. Two groups that are less well assisted are Pacific Island groups and those with low literary skills.

Pacific Island Community groups

As stated in Cabinet Paper EDC (02) 90, one aim of the NAP was to encourage those who might not otherwise apply for bankruptcy, who may instead rely on informal lending arrangements, to seek an alternative through NAP to help them break cycles of debt.

A recent desk research project undertaken for the Ministry of Consumer Affairs by Research New Zealand[14] examined the role that fringe lenders play at the lower end of the credit market, to which low income communities resort when unable to borrow from banks and other mainstream credit institutions.

The desk study suggested that many fringe lending companies operate in Auckland, and over half of the 185 companies identified in the study, advertise in at least one community or ethnic newspaper with Tongan and Samoan papers carrying the most advertisements. This suggests that a large number of Pacific Islanders are serviced by fringe lending companies.

[14] Cagney, Paula and Debbie Cossar, *Fringe Lenders in New Zealand: Desk Research Project*, Research New Zealand, July 2006.

Our survey with budget advisors confirmed that there is less awareness of NAP among ethnic groups, particularly Pacific Island communities, followed by Maori and other groups [consider inserting bar chart]. Our focus groups suggested that NAP tends not to be as good at reaching Pacific Island Community groups and those with English as a second language, who are deterred by English-only forms and information.

This corresponds with an analysis of statistical data from the ITS, that there are low levels of representation of Pacific Island Community groups in NAP.

Feedback from our focus groups, and our case study of those who chose not to go through NAP, indicated that Pacific Island Community groups are deterred by NAP due to a perception that they will not be able to travel out of the country (which is an important cultural custom so as to visit family). While this is not the case for NAP, it is a requirement that NAP debtors notify the Official Assignee of overseas travel. This administrative requirement also deters these groups.

Focus groups indicated that Pacific Island groups often enter financial difficulty due to cultural needs to attend family events, such as funerals, overseas. Budget advisors considered that fringe lending companies are targeting Pacific Island groups, at high interest rates (discussed later in this report), and that these groups tend to attempt to keep financing of debt within family and friends. Budget advisors also indicated that these groups tend to have secured loan debts, which makes them ineligible for NAP.

We also found that Pacific Island Community groups tended to be heavily indebted to informal fringe lenders before the point of seeking out a budget advisor, by which time they were often in a difficult and unmanageable financial situation.

These factors lead to under-representation of Pacific Island groups in NAP, and suggest that some specific awareness-raising among these communities, to alert them to NAP as a potential alternative to relying on fringe lending companies to manage a difficult financial situation, may be beneficial. Our focus groups suggested that having promotional material (and application material) available in different languages, including Samoan, would be useful.

Low literacy skills

Related comments from focus groups indicated that there are significant numbers of debtors for whom English is a second language. Coupled with observations that there are also clients for whom mental health issues are prevalent, and large numbers of beneficiaries represented in NAP, focus groups indicated that this results in large numbers of NAP debtors with low general literacy and financial literacy skills.

Focus groups indicated that many NAP debtors do not understand the legalities, implications, or way that insolvency information is presented.

This may explain some of the findings from the evaluation discussed in earlier chapters, that debtors had not fully anticipated the implications that NAP would have for their credit situation after NAP, despite publicly available information on this on the ITS website.

Focus groups suggested that presenting information in less technical language, making more use of auditory and visual information such as graphics and pictures, would better cater to the information processing style of these groups.

We also received a number of requests across the evaluation for better education and training in financial literacy skills, both as a condition of the NAP and at earlier stages in citizen's lives, such as at schools.

3.3 Some individuals choose not to go through NAP – a case study

A small number of people who are eligible for NAP are known to decline using the scheme. This section examines the situation of people who may decline to use NAP compared to those users of NAP and their stakeholders who are covered in the major parts of the evaluation.

We undertook a case study of people who have declined NAP[15], and some indicative themes emerged. We found the themes to be consistent with specific comments made in other parts of the evaluation, and they are listed in order of their observed importance to people who decline NAP. More than one of the themes was usually cited by the people concerned.

Being responsible

The case study found that people eligible for NAP may decline to use the scheme in favour of taking responsibility for their debt and repaying their creditors.

Debtors often seek help from budget advisers having already made a prior decision to apply for NAP. Alternatively, debtors may work through their respective financial situations with a budget adviser and, in the process, learn of their eligibility for NAP.

In either case, however, some people have a sense of responsibility that subsequently overrides their eligibility for NAP entitlement. And, in being responsible, they opt to repay their debt. Repayment of debt then is usually managed with the on-going help of a budget adviser. Thus, where a debtor wants to be responsible and fair to a creditor, and repayment is both a viable and sustainable option (although often not an easy choice), a budget adviser will work closely with their client to repay the debt.

Changing behaviour

The case study found that people eligible for NAP may decline to use the scheme because they have serious intentions to change the way they manage their money.

[15] The small case study, based on the greater Wellington area, was completed as part of the evaluation to obtain some insight into why eligible people decline NAP. The study involved talking directly with people who had declined NAP and budget advisers whose clients had declined NAP. The study also reviewed findings from the evaluation focus groups and the survey findings for relevant information. The full report on the counterfactual study is available separately.

Debtors often use NAP as an immediate solution to their indebtedness. However, some people are determined to change their behaviour and learn to manage their finances competently and responsibly in the long term, and avoid further indebtedness.

With this attitude of changing their behaviour, some eligible people will decline NAP and elect some other way to deal with their immediate debt (e.g. Summary Instalment Orders (SIO), repayment or bankruptcy), but they will also become involved in sustained work with a budget adviser on managing monies responsibly and effectively (of course people who use NAP may also work similarly to change their behaviour).

Avoiding stigma

The case study found that people eligible for NAP may decline to use the scheme to avoid the stigma of insolvency.

Some debtors, with an eye to the future, do not want to be stigmatised for using NAP. They believe that, by not using NAP, they avoid being labelled publicly as insolvent or a poor credit risk, and so on. Furthermore, if they did use NAP, they believe they would be severely restricted with respect to their opportunities and choices in future years – that is, they want to eschew limitations on their future prospects (e.g. for job applications, for obtaining credit).

Being deterred

The case study found that people eligible for NAP may decline to use the scheme owing to its complexity or on the advice of their budget adviser. Although it does not appear to be a significant deterrence factor, the nature and design of NAP can contribute to a decision not to use NAP. Deterrence factors here include: the long, repetitious English language-only application form, the Internet-based application process, excessive administration, or the need to provide personal information to ITS.

Some people appear to decline NAP simply on the advice of a budget adviser (e.g. one client was 'told' to use SIO rather than NAP).

Box V: Examples of debtors who declined NAP

An indebted couple on pensions declined to use NAP – they felt responsible for repaying what they owed and, with the help of their budget adviser, tried to clear the debt (this situation has become more difficult since one of the couple died, and NAP remains a future option).

An unemployed parent in debt declined to use NAP – the scheme was not seen as an effective solution for the on-going problems (i.e. the lack of a job and the lack of effective help for the family), and there was a fear that using NAP would limit future opportunities, such as securing a mortgage for purchasing a house in future.

A prostitute declined to use NAP – this decision was made to avoid insolvency and from a wish to be fair to creditors and repay debt.

NAP, debt and managing money

In the case study, the discussions with budget advisers were not limited to the matter of NAP and why eligible people declined to use the scheme. Usually, the discussions were quite wide and covered also NAP and the application process, insolvency options, and factors underlying indebtedness among their clients. The important themes that emerged from discussions with the budget advisers are summarised in this section.

NAP lifeboat

Many people in debt seek help from budget advisers having decided already that they want to apply for NAP. Also, many debtors seen by the budget advisers see NAP as an immediate solution to their debt problems – for some people, NAP is their only real option (e.g. for unemployed people, beneficiaries, or Public Servants hoping to secure job tenure). However, debtors often do not look beyond NAP. Where a long-term solution to indebtedness is needed, using NAP only is not sufficient.

Motivating people

Dealing with indebtedness and changing patterns of financial behaviour is clearly a challenge, but two factors are likely to be of major importance. Firstly, motivating people to learn to be financially responsible, and, secondly, helping motivated people to become financially competent. Building these two factors somehow into managing insolvency processes, where appropriate (i.e. NAP, SIO, bankruptcy, or repayment) may be more effective in the longer-term than either the lifeboat- or avoidance-type approaches.

Community support

Community-based resources, budget advice and guidance can be powerful ways for helping people both to deal with debt and to manage money responsibly.

Examples of community-based support, besides established budget advice service groups, include monthly workshops on managing money, budgeting, dealing with insolvency, etc., and community funds available at no or very low interest rates for people in extreme need. Active promotion of initiatives through community-based schemes with linkages to official channels (e.g. ITS) may help to alleviate indebtedness for some people (e.g. Pacific peoples).

Role of fringe-lenders

Budget advisers observed that dealing with debt by means of money obtained from ready-cash groups is a disaster for many people[16]. Often, the budget advisers do not see clients until after money has been borrowed from a fringe-lender and a bad debt situation has become a serious debt situation.

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[16] An MSD report notes, 'Internal and external stakeholders raised concern about the perceived targeting of poor communities by fringe lending agencies. Examples given were lending agencies advertising "beneficiaries welcome" and trucks selling high interest hire-purchase goods and targeting poor neighbourhoods' (Pockets of significant hardship and poverty', CSRE, MSD, 2007).

Some form of regulated accountability to ensure responsible lending by fringe-lenders was suggested by budget advisers. Such accountability could help prevent serious indebtedness ensuing for people already struggling to manage debt.

Summary

People who decline NAP

People who are eligible for NAP but do not avail themselves of the scheme do not appear to represent a distinctive group that is markedly different from people who use NAP. In other words, demographically, people who decline NAP have the same broad characteristics as the NAP users covered in the evaluation, and the same features of indebtedness found in other studies of debt in New Zealand and elsewhere.

However, there are two things that appear to distinguish the people who decline NAP from NAP users.

Firstly, they assess how they manage money and their options for dealing with indebtedness, often with the help of a budget adviser. Secondly, they make a conscious decision to pursue options other than NAP for dealing with their respective situations. The people who decide not to use NAP intentionally take a path that is different from either those people seeking a short-term, rather than long-term, solution to their debt problem, or, those people who have no real choice other than NAP for dealing with their debt.

Mostly, it appears that eligible people who decline to use NAP make their decision on the basis of dealing responsibly with their debt, even when this is not an easy option. However, some peoples' decisions not to use NAP are less constructive – e.g. declining NAP and dealing with debt basically by trying to avoid it.

Conclusions

The main conclusion drawn from the case study is that some people who use NAP could learn from the people who declined to use NAP. In other words, while NAP may provide a short-term solution to indebtedness, and, admittedly, for some the only chance for a fresh start, the underlying problems of poor budgeting and mismanaging money may be dealt with in part by encouraging people where possible to seek longer-term solutions – as demonstrated by some of the people who declined to use NAP[17].

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[17]The inferences in this section are based on a study that covered only a small group of people who had very individual circumstances affecting their individual decisions to decline using NAP. Any generalising about this group needs to be treated with caution.

3.4 Less awareness of alternatives to NAP, including SIO

We found a mixed view across the evaluation on whether debtors are sufficiently aware of, and using, alternatives to NAP, such as Summary Instalment Orders (SIO).

On the one hand, we received a view from interviews with stakeholders, financial institutions, and focus groups that some NAP debtors have decided that NAP is the appropriate option for their situation without being willing to consider alternatives such as SIOs. From some quarters, we found a view that more NAP debtors should be considering the SIO insolvency route, particularly as they considered that SIO better encourages financial responsibility and changed spending behaviour.

Creditors were particularly of the view that alternatives to NAP better encouraged financial responsibility and were more likely to lead to changed behaviour as the incentives to change are stronger given the longer time periods for the insolvency periods, and the requirements for regular contact with a supervisor for SIO.

In some cases, the view that there is insufficient use of SIO was considered due to a lack of awareness on debtors' behalf of alternative options; in others due to debtors' determination that they wanted to pursue NAP as they considered a repayment option too administratively and psychologically difficult; and in others a view that SIO is not sufficiently promoted as a good alternative. It was acknowledged that for some individuals, incomes are so low that repayment options are simply not feasible.

Our survey of budget advisors also gave a mixed picture on this. For example, 51.3% of budget advisors consider debtors should be making more use of repayment options such as SIO, whereas 48.7% consider that the different routes are being used appropriately to cater to different people's circumstances.

Insolvency officers are in a position to assess whether a repayment route is a possibility for an individual, and the ITS should ensure that the intended rigour of this process is working as well as it can. For example, by ensuring that insolvency officers are sufficiently mindful when assessing a NAP application, whether the NAP application could or should be submitted as an SIO.

However, there were also strong calls, discussed later in this report, for more punitive elements to be introduced to NAP, that include a repayment requirement for reasons noted above.

4. Findings: Is the NAP administratively efficient?

4.1 Creditors are observing abuse of NAP

The evaluation interviewed a selection of creditors who have been involved with NAP debtors, either as a result of writing-off debts under NAP legislation, or as an observant third party (such as a bank who becomes aware of a NAP application, but does not necessarily have lending with the individual). Those interviewed included banks, a consumer finance institution and some government departments.

Observations on debtors' spending behaviours

Creditors consider that in general NAP encourages, and is continuing to permit, an irresponsible approach to consumer finance and debt accumulation. Banks were strongly of the view that NAP provides too easy a route for individuals to write-off debt, without sufficient concern for, or accountability for the consequences of their actions.

Banks observe spending by consumers and debtors both before and after a NAP application. Banks are in a privileged position to be able to observe debtors' spending patterns, through bank accounts and credit card statements, observing spending behaviours and observing exactly what items debtors are spending funds on.

Banks informed us that in general they are observing a number of phenomena that relate to NAP debtors' situations. Firstly, they are observing in recent decades a trend for consumers to finance consumer purchases through lending, rather than saving to pay when means allows. This is a general worldwide phenomenon as we become more used to relying on credit as a society. However, problems occur with this model when spending starts to outweigh the income available to repay debts accumulated, or when the debts accumulated become too many in number.

We found a view across our evidence streams, from creditors to budget advisors, that cultural problems are emerging with individuals' attitudes towards 'spend now, and pay later'. A strong view emerged that better financial literacy in managing finances, spending and budgeting is needed across society, and that education in these areas is urgently required in schools, as well as for adults.

Banks secondly informed us of an increased cultural phenomenon of spending on consumer luxury goods, such as televisions and jewellery, financed by lending arrangements, at the same time as debtors claiming that they are unable to make bill repayments. The problem of balancing desires for consumer luxuries with obligations to creditors or bill payees is seen by debtors as a problem created by others, rather than one solved by budgeting. See Box VI for examples provided to us by banks.

Box VI: Banks are observing a cultural phenomenon of irresponsible consumer spending

> *"We're seeing an attitude of irresponsibility and entitlement develop as a result of NAP, that we didn't see prior with other insolvency routes. Now, people think 'I can get away with this', and disappear overseas. Insolvency is not the big deterrent that it used to be prior to NAP."*
>
> *"We see people who are consolidating their debts to get them under control, are then spending on clothes, at bars and Jenny Craig membership. People have an attitude that it is someone else's problem that they can't pay their bills, rather than their own problem or doing."*
>
> *"We see NAP debtors spending on pizzas, alcohol and takeaways, rather than budgeting and spending wisely."*
>
> *"Education in life skills at schools and in financial literacy is needed. We see the amounts that low income earners that are debtors are spending on takeaways, and we discuss with them how cheap spaghetti bolognaise is as an alternative!"*
>
> *"Our main NAP customers used to be youngsters, but now seeing all age ranges. The majority are people who have run wild with credit cards."*

While there was an acknowledgement that NAP has helped some individuals in genuine circumstances, banks held a strong view that irresponsible consumer spending was often at the root of large lending accounts with creditors.

Thirdly, banks informed us that they are seeing NAP debtors continuing to spend irresponsibly on consumer luxuries even once they have been accepted for NAP, and re-enter a debt cycle. Banks considered that NAP has not encouraged changed behaviour and debtors are getting back into debt. This has led some banks to develop a policy of not granting further lending to NAP debtors. Banks informed us that they receive repeat requests from NAP debtors for further lending, including online applications and overdraft lending, even though further lending has been rejected already.

These observations contribute to a view that NAP is allowing debtors to easily exit from responsibilities or consequences arising from previous irresponsible spending behaviour, without sufficient incentives to encourage NAP debtors to learn from their mistakes or change behaviour.

These findings are corroborated by our survey of budget advisors, who are mixed on whether they think that the NAP is helping people in genuine situations (47.9%), or encouraging a 'get-out' of financially irresponsible behaviour (46.5%).

Patterns in last-minute spending prior to a NAP application

Creditors informed us that they are observing some abuse of NAP, including patterns in last-minute spending.

Both government and commercial creditors informed us that they are retrospectively observing patterns of spending and borrowing accumulating a few months prior to being alerted to a debtor's NAP application. It is difficult to identify whether spending and borrowing accumulates over the months prior to a NAP application due to a difficult financial situation becoming uncontrollable, or whether last-minute purchases are pre-meditated in the knowledge that a NAP application is imminent.

Whether patterns in last-minute spending are pre-meditated or not, creditors are observing sufficient patterns to suggest that further controls around NAP need to be introduced to provide better safeguards against such gaming.

Other examples of actions respondents saw as gaming include:

- making purchases on credit cards, or cash advances, after submitting a NAP application, but before a creditor has been alerted to the NAP application, and therefore before a creditor is able to decline further lending;
- opening a bank account in the same week as NAP to transfer cash into a safe place;
- paying off debts over a few months prior to a NAP application in order for debts to be contained within the $40,000 NAP limit (however, debtors are paying-off some debt to make themselves eligible for NAP);
- considering the purchase of a car to the value of $5,000 after entering the NAP to be an entitlement;
- and considering accumulation of a further $1,000 of lending once entered into NAP to be an entitlement.

There is some debate over whether these examples constitute fraudulent debts or are simply gaming behaviours.

However, for fraudulent debts banks inform us that while fraudulent debts can be pursued through legal channels, it is administratively very costly and difficult to do this and so is not often done. Further safeguards around the policy are needed to prevent fraudulent debt accumulation occurring. For example, it may be possible that recent debts 6 months prior to a NAP application are not eligible for write-off under NAP.

Most budget advisors in our survey (86.5%) reported that they have not observed any patterns in last minute purchases or debt accumulation prior to a NAP application. However, our focus groups did note some awareness of this. Only 13.5% of our survey respondents have observed some patterns, and provided comments on this. Comments include that there are some pre-meditated purchases, but rather than this being the majority of cases most debtors have simply let their consumer spending get out of control, or have long-standing debts. Budget Advisors also reported that if abuse of the procedure was observed, they would refrain from recommending NAP as an option for the debtor.

There was an expectation in budget advisors' comments that the ITS would be able to identify any misuse of the system. One of our creditor interviewees was also of the impression that ITS staff would be able to rigorously assess whether any abuses of the policy, or gaming behaviour, had taken place, and so were not currently monitoring or checking their own records.

As noted above, it is difficult to identify whether purchases and debt accumulation prior to a NAP application were pre-meditated or not, and in the course of this evaluation we have not found any particular systems or processes in place under NAP that would be able to do so. This is potentially a weakness in the policy, and given creditors' observations of the presence of some gaming behaviours, further consideration of controls to mitigate any gaming behaviour or abuses of the system would be beneficial.

INSOL international best practice guidelines on managing consumer debt[18] recommend that applications for insolvency should test whether debtors have acted in good faith. The guidelines do not make any recommendations for how this should be done, and the answer to this problem is not clear cut. Further policy analysis should consider possible solutions to this problem. Suggestions from our evaluation include eliminating debts from NAP accumulated 6 months prior to an application (as well as other suggestions to improve NAP noted elsewhere in this report).

Declarations of debts and assets

Creditors inform us that debtors are not always accurate in their declarations of amounts of debt, numbers of creditors, or assets available when applying for a NAP.

We received a number of examples of NAP debtors who would have had debts over the NAP limit of $40,000 if all debts had been declared, and would therefore have been ineligible for the NAP insolvency route.

Creditors indicated that the reasons for inaccurate declarations of debt include that debtors have been unaware that they are required to declare government debt as part of their NAP application (for example with the MSD, or Inland Revenue); unaware that they are required to declare debt with banks as part of their NAP application; or have deliberately concealed some debts in order to be eligible for NAP instead of bankruptcy.

We were further informed of examples where assets, such as savings, had not been declared as part of a NAP application. For example, one bank informed us of a case where a new customer had opened a savings account with considerable assets. It later came to light that the customer had applied for a NAP application a few months after opening the new savings account, but had not declared these assets as part of the NAP application.

Where these examples have come to light, creditors informed us that they have on occasion submitted objections to a NAP application to the Official Assignee.

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[18] INSOL International Consumer Debt Report: Report of Findings and Recommendations, *INSOL International*, May 2001 (see appendix).

However, creditors inform us that it is very difficult to identify in most cases whether an individual creditor's debts, or assets held by the debtor, have been declared accurately under the NAP application. This difficulty is because:

- The process for creditors to match up lists of NAP debtors, provided by ITS, against creditors' client lists is currently manual, and thereby administratively costly, resulting in limited monitoring and reporting on inaccuracies or abuse;
- All creditors and amounts of debts are not itemised in notifications to creditors, or in one central database, for creditors to check whether their lending arrangements, or any assets held, have been declared accurately by the debtor; and
- Assets and debts are not vested in the Official Assignee for NAP, as they are with bankruptcy and SIOs, which makes this process simpler for these other insolvency routes.

Some discussion of the role of credit bureaux, such as Veda Advantage, came up over the course of discussing this topic. However, it was noted that these bodies do not help with the problem noted above of identifying the full range of debts, assets and creditors declared in a NAP, as Veda Advantage only reports on defaults on loans. Interviewees also reported that some loan providers are not reporting defaults to Veda Advantage.

Given the reports of unintended gaming behaviour around NAP, and observations of instances of this across our different evidence sources from creditors to budget advisors, amendments to the NAP administrative system in these areas should be considered as a priority in order for better safeguards to prevent risk of gaming.

Costs to creditors of NAP

As noted above, creditors informed us that the administrative processes involved in identifying clients that have been admitted to NAP are labour intensive and costly for creditors to administer.

In addition, creditors informed us that the administration of clients' accounts who have entered NAP entails large compliance costs. For example, we were informed by one bank that we interviewed that it has had to employ an external organisation to manage the workload created by the administration of liaison, writing off clients' debts, and closing accounts.

We only interviewed a small selection of creditors, so the full compliance costs of administering NAP across the economy are unknown. However, we received a very clear message from the creditors that we interviewed that these were significant in all their cases. To fully evaluate the compliance costs created by NAP legislation, further follow-up work with creditors, such as a comprehensive quantitative survey, is needed.

Creditors also informed us that they are writing off considerable amounts of debts due to NAP. We were informed of one example that totalled $9 million since 2009. Further discussion of the direct and indirect costs displaced across the economy by NAP is noted in Chapter 5.

Concern at these amounts is founded in the possibility that in the absence of NAP, debtors may instead have been encouraged to attempt to manage their difficult financial situations and repay debt. The costs displaced across the economy by NAP may be costs that might not otherwise have occurred without the policy intervention.

For example, it is not necessarily the case that NAP debtors would instead have entered bankruptcy, but may have either entered a Summary Instalment Order or considered other repayment routes.

Creditors' concerns that NAP provides a simple incentive to write off-debt, at a large cost to the economy, for both the private sector and government, should be considered seriously. It is possible that an unintended consequence of introducing NAP includes that a problem of moral hazard has been created. That is, in economic terms, that the introduction and existence of NAP provides debtors with an incentive to easily write-off debt, rather than take the more difficult route of longer-term repayment and better financial management. Further policy consideration should be given to this problem.

Creditors' conclusions

Creditors informed us that they are strongly in favour of bankruptcy and SIO routes as alternatives to NAP, as they consider that bankruptcy and SIO routes are better at facilitating change in spending and budgeting habits, encouraging responsibility for financial decisions and mistakes, and preventing gaming behaviour.

Moreover, creditors considered that NAP offers too quick a solution to a problem that, in the absence of NAP, may be rectifiable of its own accord. For example, an unexpected redundancy or period of unemployment may lead to a short-term financial difficulty with meeting repayments for debt accumulated, but employment may be recovered in future years. As NAP is a one-year "immediate" solution, the possibility of repayment (when this becomes possible over the medium-term, or long-term future) is eliminated. Conversely, as an interesting comparator, the principle of student loan repayments over a prolonged time-period takes this factor into account.

Financial lending institutions informed us that they consider that NAP needs to be amended to incorporate more punitive elements to discourage debtors from seeing the procedure as an easy way out of financial mismanagement.

These concerns are mirrored in our survey of budget advisors. Comments indicate that NAP should exist to help genuine cases where clearing debt would enable a fresh start, and that it is largely doing so. However, comments also indicate that there are some cases where financial irresponsibility is at the root of people's situation, and that there should be further safeguards attached to NAP to avoid abuse of the system in these cases.

Suggestions across our evidence sources included:

- A longer time-period over which debtors are held in insolvency in NAP, to better encourage changed behaviour;
- A longer, or indefinite, time-period over which debtors who come into means of repayment should be expected to repay debts;

- Financial literacy and budgeting skills should be an integral part of the procedure to ensure that better financial choices are made in the future;
- Visiting a budget advisor should be a condition of applying for NAP;
- Visiting a budget advisor 6 months prior to an application being accepted should be a condition of NAP, to assess whether repayment is an option;
- Follow-up with a budget advisor should be a requirement after exiting NAP.

4.2 Banks are reluctant to provide further credit to NAP debtors

As NAP debtors informed us in the evaluation survey that they were experiencing difficulty accessing credit and lending since entering NAP, we discussed creditors' views on providing further credit to NAP debtors.

Banks are open in acknowledging their policy to decline any further credit or lending to NAP debtors, including closing all trading (including savings) accounts with NAP debtors. Some banks are also refusing to enter any banking relationship with a previous NAP debtor, as they consider the individual too risky. Creditors informed us that while NAP debtors are listed on the insolvency register for a relatively short time-period, internal records of uncleared debts are held by creditors indefinitely, and recorded in credit bureau scores. Creditors informed us that these factors strongly influence any decision to provide further lending, and in NAP debtors' case, are likely to lead to a rejection of any further lending requests.

NAP debtors' responses to our survey indicated that they perceived their situation to be different to bankrupts' situation, and expected that they might be treated more favourably, or without a perceived stigma that is attached to bankruptcy. They indicated in survey responses that they were surprised to find they were being treated similarly to a bankruptcy case.

Conversely, banks informed us that they administer NAP debtors similarly to bankrupts. However, in some cases, banks informed us that they perceive NAP debtors to be more risky than bankrupts, and are therefore more likely to decline engaging in a banking relationship with NAP debtors.

This raises some interesting policy questions for government, as the number of ex-NAP debtors grows, and as increasing numbers of NAP debtors are exposed to future banking difficulties.

4.3 Lending behaviour by financial institutions has impacted on debtors' situations

We found a view across the evaluation evidence sources that for many NAP debtors, lending has been issued too freely, over and beyond debtors' realistic abilities to repay loans.

Our survey of budget advisors found that they strongly consider that credit cards are too easily available (92.9%), and that personal finance through fringe lending companies is too easily available (98.6%).

Qualitative comments include that lending institutions are lending irresponsibly to people who clearly are unable to repay loan amounts; that finance companies should be more prepared to accept small repayment agreements (such as $5.00 per week), or that interest should be frozen to allow repayment to be possible.

Our focus groups with budget advisors indicated that many debtors on low incomes had been issued lending by financial institutions that did not reflect realistic assessments of income and abilities to meet necessary expenditure for daily living and bills, as well as repay lending over time.

Concern was expressed at lending practices that had not required any verification of income, and in some cases had not entailed credit, or due diligence, checks to determine the financial viability of the individual.

Most budget advisors that we surveyed (84.3%) consider that lending institutions' behaviours that impact on debtors are not being sufficiently considered and regulated by government. We were provided with anecdotal examples of extreme interest rates, such as 400%, that prohibit debtors from a realistic opportunity of repayment of debt.

We also found some concern at the extent to which beneficiaries had been issued lending by lending institutions, particularly because their ability to repay lending based on income from benefits is likely to be very restricted. This concern becomes important when taking account of statistics that over 50% of NAP debtors are beneficiaries.

We found a view that in some ways, NAP is a beneficial market mechanism that incentivises lending institutions to lend more responsibly.

We found financial institutions to be in agreement that there has been over-lending in the past. In some cases there was a view that the recent recession has helped with this, but in others not. For example, we found concern among financial institutions themselves that there is still a culture of aggressive sales targets among competitors to win new lending arrangements, and at high interest rates for less formal lending institutions.

Financial institutions advised us that the problem of over-lending is exacerbated by consumers' behaviours: consumers are dishonest and unrealistic in declaring their ability to repay credit, and amass too many liabilities too easily with too many different lending institutions. While borrowers are obliged to declare all liabilities with other lenders in lending applications, banks and budget advisors told us that borrowers are not doing so. It is difficult for lenders to accurately assess ability to repay lending when full declarations of income, expenditure and liability are not declared by borrowers. Once again, we received calls for better financial literacy in basic budgeting and financial management skills.

4.4 Evidence suggests that the application process could be improved

The evaluation found mixed evidence on the accessibility of the application process for NAP, for different reasons.

Most (85.21%) budget advisors in our survey consider that the application process for NAP is sufficiently accessible.

However, 14.9% consider that it is not very accessible. Comments across our survey and focus groups with budget advisors revealed a clear message that debtors are daunted by the application form, requiring significant assistance to complete it; in some cases we received examples of up to 6 repeat visits to budget advisors to gain assistance with completing the application form. Budget advisors informed us that administering the application forms for NAP is a resource intensive process for the volunteers.

Reasons for some of these difficulties with completing NAP application forms include that some NAP debtors have difficulties with literacy and English language, and some lack access to the internet.

This may explain ITS statistics that most applications for NAP (approximately two thirds) are submitted manually, rather than electronically. Budget advisors that we surveyed supported this statistic, with most applications being assisted with manually (86.5%) rather than electronically (13.5%). Comments include that the application form is too lengthy or complex to comfortably complete on-line, or internet access is limited.

Given the high numbers of applications that are submitted manually, there is possibly some efficiency for ITS that could be gained by simplifying the electronic application process.

Although the application process is onerous, in part to discourage gaming, the process is being streamlined. Applying for insolvency is a complicated process, and simplifying the application process is difficult to achieve at the same time as ensuring a robust assessment of an individual's circumstances. However, suggestions to improve the process include:

- omitting the business section from the Statement of Affairs for NAP applications, as this is daunting to some NAP applicants, and is not required for submitting a NAP application; and
- providing applicants with a checklist of information that they will require in order to complete the application form.

Changes have been introduced recently that have improved the on-line NAP system. The changes are good, but further work is needed to make the system more user-friendly to debtors.

It is important to acknowledge, however, that although the NAP processes are difficult for many debtors, the service provided by ITS staff is valued highly by NAP users.

It is also noted that efforts are being made to make NAP applicants more aware of their credit blacklisting following NAP (i.e. via website and brochures).

4.5 Conditions and criteria for NAP

The limit on $40,000 of debt

In general, we found that stakeholders consider the limit of $40,000 of debt to be about right for NAP.

Most budget advisors that we surveyed consider that the $40,000 limit on debts is about right (78.4%). Only 12.2% consider that the limit is too low. Some comments provided in the survey on this issue include that the $40,000 limit is about right for a suitable amount of consumer debt, and to avoid irresponsible spending. Creditors also were of the view that any higher limit for NAP would encourage further irresponsible spending.

However, a number of issues are identified in our survey of budget advisors and focus groups with how the limit and conditions around the debt limit exclude some individuals from entering NAP, or do not alleviate their difficult situation. These issues include:

- That WINZ debt, Child support debt, student loan debt, and mortgagee sale debt set a number of people over the limit;
- That the criteria around secured and unsecured debt restricts applications for many of the Pacific Island community, and other debtors;
- That the criteria around secured and unsecured debt has limited the beneficial impact of NAP for some NAP debtors, as in some cases most of their debt was secured debt, and they were not in a position to release funds from this debt.

Further analysis of these issues would be fruitful should policy teams consider raising the limit for NAP, particularly given the view that raising the limit would encourage further irresponsible financial management. One possibility, rather than raising the limit, is to exclude certain types of debt, or include a ring-fenced amount, for example for mortgagee debt, from contributing to the $40,000 limit for NAP.

Difficulties around KiwiSaver

We found that KiwiSaver providers are proving reluctant in releasing assets under hardship conditions, even though this is legislated. Some budget advisors are experiencing difficulty assisting NAP debtors with their NAP application, as KiwiSaver providers are refusing to release funds.

We found a view however, that there should be limits on the amount of funds that NAP debtors are allowed to release from KiwiSaver. Focus groups suggested that NAP debtors should only be allowed to release funds that they have personally contributed, rather than any contributions made by an employer or government. We also found some debate over whether retirement savings for the future should be released to alleviate a short-term current difficult situation. There was a suggestion that providing NAP debtors with an easy route to use KiwiSaver funds now may not be in individuals' long-term interests.

ITS are currently addressing some of these difficulties with KiwiSaver providers, and in our view there are some policy considerations worthy of further work around KiwiSaver's interaction with NAP.

Student loans

Student loans are currently excluded from being written-off under NAP. Our evaluation overall did not find any concerns or issues with this aspect of the policy. We consider that this aspect of the policy should remain, otherwise the incentive for high numbers of New Zealand students to alleviate growing student debt burdens through NAP would become too great.

A difference between NAP and bankruptcy is that insolvents under NAP are not prohibited from taking out student loans in order to continue studying. Under bankruptcy they are. Our survey of NAP debtors received some comments indicating that being able to continue to study, and take out student loans, was beneficial in enabling individuals to continue to be productive members of society (such as completing a PhD).

Co-ordination of government

We received some comments from our focus groups of budget advisors and survey of NAP debtors that both are experiencing difficulties liaising with the range of different government departments over NAP.

Budget advisors are mixed on whether the relevant parts of government involved with NAP are well co-ordinated and working effectively. For example, 56.8% answered yes to this question, whereas 43.2% answered no.

Comments mainly focus on difficulties and frustration liaising with Work and Income, and confusion across government agencies over how Work and Income debts, and debts with other government agencies including Inland Revenue, should be treated under NAP. Comments suggest that a more co-ordinated approach to NAP by all government agencies affected would be beneficial to all concerned and further analysis of the detail and context of these comments would be fruitful if required by policy and operational teams.

5. Findings: Is NAP a cost-effective alternative for government?

5.1 Anticipated savings of NAP

The original objectives of NAP, stated in Cabinet Paper EDC (02) 90, included, amongst other objectives discussed elsewhere in this report:

- to provide a simple procedure which minimises administration costs to the state.

Cabinet paper EDC (02) 90 anticipated that administering NAP would be more efficient for the state than bankruptcy. We have briefly examined the costs and efficiencies of administering NAP, compared to bankruptcy, for both the ITS, and for stakeholders and creditors, both private sector and government, involved in administering NAP.

Based on findings emerging from the limited work on costs and savings that we have undertaken for this evaluation, we consider that further in-depth work should be done in this area to estimate the full costs and benefits of the legislation.

Cabinet Paper EDC (02) 90 estimated net fiscal savings of $1.45 million in 2004/05 increasing in out-years, largely due to student loan liabilities that would previously have been discharged under bankruptcy conditions, but would now be retained under the NAP. The bankruptcy related write-off of student loans was increasing yearly and stood at around $4 million in 2001/02. Officials estimated that almost half of those who would otherwise become bankrupt would instead enter the NAP, leading to savings of around $1.9 million in 2004/05, with the amount increasing in out-years.

Costs of the policy were estimated at an increase of $0.25 million to Vote Commerce in 2004/05 for extra resources to administer the procedure, anticipating that the procedure would attract additional debtors. No extra funding was anticipated for those debtors for whom the NAP is an alternative to bankruptcy.

Costs of the policy to Vote Social Development were estimated at an additional $0.2 million in 2004/05 and out-years to meet the anticipated increase in student loan drawdowns. This increase in anticipated costs to Social Development is due to conditions of the NAP whereby debtors are not prohibited from taking out student loans in order to undertake further study. Under bankruptcy, debtors are prohibited from taking out student loans during the term of their insolvency.

Table 2: Estimated costs and savings of NAP in 2004/05 and out-years

	Cost	Savings
Vote Commerce	$0.25 million	Efficiency gains
Vote Social Development	$0.2 million	
Vote Inland Revenue		$1.9 million
Total savings through introducing NAP		$1.45 million

Source: Cabinet Paper EDC (02) 90

We discuss below the extent to which these anticipated savings have materialised.

5.2 Funding to ITS to administer NAP

Total funding to administer the ITS since 2007/08 has increased year on year, to reflect increased numbers of insolvents – e.g. ITS funding in 2010/11 was $13.1M compared with $11.5M in 2007/08.

The number of debtors applying to the ITS has been increasing year on year (see Table 1 and figure 1 above. While numbers of accepted NAP applications have been increasing each year, so have bankruptcy and SIO applications. Evidence across the evaluation suggests that this increase in all types of insolvency applications has been partly due to the global economic recession.

Table 1 shows that a high number of NAP applications are rejected, and some terminated. An analysis of ITS data on the main reasons for rejections and terminations shows that the most common reasons are:

- An incomplete application; and
- Debts higher than $40,000 and objections to NAP applications by creditors.

Our findings from the evaluation suggest that efficiencies in administering rejections and terminations could be gained by ITS. Findings suggest that some NAP debtors have difficulty completing NAP applications due to low literacy levels, and difficulties with English as a foreign language. Budget advisors suggested that:

- simplifying the application form by providing a checklist of all the required information needed prior to completing the application form would assist NAP debtors to provide a more complete application form; and
- translating the form into different languages would assist NAP debtors in completing the application form.

As discussed in Chapter 4, creditors expressed some concerns at the difficulties with monitoring whether debtors have correctly declared all creditors, debts and assets in a NAP application. The number of terminated applications due to debts being higher than $40,000 may be reduced by introducing for NAP the same conditions for other insolvencies, whereby creditors are requested to file proof of debt – this may require legislative changes for similar conditions as bankruptcy and SIO.

Comparisons with other international jurisdictions' insolvency rates also show a trend of increasing numbers of applications. New Zealand's rates of insolvency as a percentage of the population are comparatively low[19].

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[19] Source: ITS internal presentation. Note that we have not undertaken an in-depth literature review or case study of international comparisons for this evaluation.

Numbers of insolvency applications, including NAP applications, have been more than those anticipated by Cabinet Paper EDC (02) 90. The Cabinet Paper estimated that the introduction of NAP legislation would result in a small increase in NAP applications, attracting additional debtors, to the value of $0.25 million. This amounts to an estimate of approximately an additional 3 FTEs per year[20].

We found concerns from creditors that NAP may have attracted significant numbers of additional debtors that may not have otherwise applied for bankruptcy, and may instead have managed their financial situation through long-term repayments. An assumption made in introducing the NAP policy is that the substantial majority of NAP insolvencies would have otherwise been processed as bankruptcies. This is not necessarily the case. Our evidence sources support the view that debtors do consider an alternative to NAP as managing their debts through repayment, and we found (discussed in Chapter 3) that some individuals do choose this route. It is therefore plausible that NAP could have attracted debtors who may have otherwise chosen to repay their debts, rather than apply for bankruptcy. This factor needs to be borne in mind when considering the costs and benefits of the NAP policy.

While there has been an overall trend in increases in bankruptcy and SIO numbers, suggesting an economic trend that reflects the economic environment, it cannot be discounted that the large increases in NAP applications since 2007 are possibly applications from debtors who may not otherwise have taken an insolvency route.

5.3 There are some efficiencies compared to bankruptcy

Cabinet Paper EDC (02) 90 expected the costs of administering the NAP to remain the same as the bankruptcy regime, but for a shorter duration, resulting in efficiency gains.

Insolvency staff indicate that efficiency gains do result from processing NAP applications in lieu of a bankruptcy application and estate for two main reasons:

- the time-period spent monitoring and administering a bankruptcy estate lasts for three years, whereas a NAP lasts for one year. NAP is also more efficient because the case requires very little administration once the application has been approved; and
- administering a NAP application takes less time than administering a bankruptcy application.

An analysis of the different time units required to administer a bankruptcy application compared to a NAP application shows that the average time to complete a NAP application is more efficient than a bankruptcy application (Table 4). Table 4 shows that administering a NAP application takes on average 15 time units, whereas administering a bankruptcy application takes on average 22 time units.

[20] Based on an estimate of an average FTE salary of $55,000 plus overheads and benefits, resulting in an FTE value of $83,000.

If NAP applications were instead processed as bankruptcy applications, this would result in additional resource required of 1.5 FTE per year. The efficiency saving of NAP is therefore 1.5 FTE per year, in addition to efficiency gains from administering the insolvency over 1 year instead of 3, which results in a saving of a further 3 FTEs if all NAP applications were otherwise processed as bankruptcies. The total resource and efficiency saving from administering NAP applications as NAP instead of bankruptcy applications is approximately 4.5 FTEs per year.

Table 4: Administering NAP applications as NAP instead of bankruptcy applications provides some efficiency gains

Av. time units to administer a NAP application (1 unit = 6 minutes)	Av. time units to administer a bankruptcy application (1 unit = 6 minutes)	Approx. additional resource required if all NAP applications were administered as bankruptcy applications	Approx additional resource required if all NAP applications were administered as bankruptcy applications for 3 years instead of 1	**Total resource and efficiency saving administering NAP applications instead of bankruptcy**
15 units	22 units	1.5 FTE p/y (including time spent on terminations)	4.5 FTE p/y NOTE: This needs to be based on the average monitoring time for a bankruptcy, rather than the application processing time	**4.5 FTEs p/y**

Source: ITS records of time-code data

Notes:

1. Based on 2009/10 data.
2. Calculations for estimating the FTE are based on the difference between multiplying the relevant time units by the number of NAP applications and bankruptcy applications for the 2009/10 year. The difference between these two amounts equates to working hours, and is approximately 40 working weeks, or 1 FTE. The calculation for the total FTE also adds time spent administering NAP terminations for the 2009/10 year, which amounts to approximately 0.5 FTE.
3. Column three includes the time taken to process terminations of NAP applications, which results in a resource requirement of approximately 0.5 FTE.

As discussed above, it should be noted that NAP applications may not necessarily have otherwise resulted in and been processed as bankruptcy applications. NAP applications, in the absence of the NAP policy, may not have been submitted to insolvency services and debtors may have managed their debts through alternative repayment routes.

5.4 Comparison of anticipated costs and savings against actual costs and savings

Savings from NAP

Cabinet Paper EDC (02) 90 estimated that the main savings from NAP would come from reduced numbers of student loan write-offs, as a result of student loans not being written-off under bankruptcy.

We have not been able to establish whether the anticipated savings to Vote Inland Revenue, as a result of increased student loan repayments, have accrued. We suggest further collaborative work with Inland Revenue to do so would be beneficial. Complications include that student repayment rates are over a long time-period, and it is not yet known whether students who have entered NAP may yet enter bankruptcy.

However, to estimate the value of the reduced write-off of student loans as a result of introducing NAP, based on 2009/10 data for the number of NAP applications who were also students (172), NAP has resulted in estimated savings for one year of $2.05 million[21] (see Table 6 below).

As shown above, efficiency savings to Vote Commerce from NAP amount to approximately 4.5 FTEs per year.

Costs to creditors of NAP

As noted earlier in this report, creditors informed us that the administrative processes involved in identifying clients that have been admitted to NAP are labour intensive and costly for creditors to administer. Creditors informed us that the same manual administrative processes do not apply for bankruptcy or other insolvency routes.

In addition, creditors informed us that the administration of clients' accounts who have entered NAP entails large compliance costs. For example, we were informed by one bank that we interviewed that it has had to employ an external organisation to manage the workload created by the administration of liaison, writing off clients' debts, and closing accounts.

As we only interviewed a selection of creditors, the full compliance costs of administering NAP across the economy are unknown. However, we received a very strong message from the creditors that we interviewed that these were significant in all their cases. To fully evaluate the compliance costs created by NAP legislation, further follow-up work with creditors, such as a comprehensive quantitative survey, is needed.

Creditors also informed us that they are writing off considerable amounts of debts due to NAP. We were informed of one example from one creditor's accounts that totalled $9 million since 2009.

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[21] Based on Inland Revenue data reported in the Dominion Post on 19th May 2011, that the median student loan balance is $11,900.

An important factor in considering the costs of introducing the NAP legislation is the amount of debt written-off by creditors that has been displaced in the economy as a result of the legislation being in place. While it may or may not be the case that these debts would have been written-off under bankruptcy anyway, it is important to identify the extent of this cost displaced in the economy.

Since introducing the NAP policy, there have been a total of 7,074 applications accepted. The average amount of debt written-off in a NAP is $21,182. This results in average direct costs of debts written-off by creditors, displaced in the economy, on average, of $149.8 million. See Table 5. Indirect costs of NAP as a result of administering the legislation, for both private sector and government creditors, are unknown. However, creditors have indicated to us that these costs have been substantial.

Table 5: Direct and indirect costs to creditors as a result of NAP are substantial

Number of NAP applications from 2007 to 2009/10	Average debt written off in a NAP	Average direct costs of debt written off in all NAPs displaced in the economy	Average indirect costs to creditors (administrative) displaced in the economy
7074	$21,182[22]	$149.8 million	Unknown

Source: ITS data

Concern at these amounts is founded in the possibility that in the absence of NAP, debtors may instead have been encouraged to attempt to manage their difficult financial situations and repay debt. The costs displaced across the economy by NAP may be costs that might not otherwise have occurred without the policy intervention. For example, it is not necessarily the case that NAP debtors would instead have entered bankruptcy, but may have either entered a SIO or considered other repayment routes.

As noted in Chapter 4, creditors' concerns that NAP provides a simple incentive to write off-debt, at a large cost to the economy, for both the private sector and government, should be further considered. It is possible that an unintended consequence of introducing NAP includes that a problem of moral hazard has been created. That is, in economic terms, that the introduction and existence of NAP provides debtors with an incentive to easily write-off debt, rather than take the more difficult route of longer-term repayment and better financial management. Further policy consideration should be given to this problem.

Other costs of NAP

Our evaluation has found that the total savings anticipated in Cabinet Paper EDC (02) 90 through introducing NAP, of $1.45m, did not take into account a number of factors that have resulted in increased costs from the legislation:

- more than expected numbers of debtors attracted to NAP, resulting in some increased administration costs for the ITS (amounting to $0.41m in 2009/10);

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[22] Average debt level based on average of all NAP estates 1 December 2007 to 30 June 2010.

- administration costs to Vote Social Development arising from NAP debtors studying (where bankrupts are prohibited from studying);
- costs of debt written off by Vote Social Development given the high numbers of beneficiaries entering NAP (53% of total NAP debtors are beneficiaries) amounting to approximately $6m in 2009/10;
- administration costs by Vote Social Development for large numbers of beneficiaries entering NAP (53% of NAP total debtors);
- costs of debt written off by Inland Revenue clients who enter NAP;
- administration costs by Inland Revenue for clients who enter NAP;
- direct costs to creditors displaced in the economy from debt written-off, which may or may not have resulted otherwise from bankruptcy applications;
- direct costs to creditors from debt written-off from more than expected numbers of debtors attracted to NAP; and
- administration costs to creditors from administering NAP separately to bankruptcy and other insolvency routes.

Table 6 shows a breakdown of crude estimates of the savings and costs for one financial year (based on 2009/10 data). The anticipated total savings from introducing the legislation, of $1.45m per year plus efficiency savings to the ITS, compares to direct costs of debt written-off under NAP of approximately $64.1m for 2009/10, in addition to significant unknown administration costs.

The direct costs of debt-written off under NAP may or may not be appropriately counted as costs of the policy. An assessment depends upon the extent to which assumptions hold on whether the debt written-off would have been written-off under bankruptcy otherwise, or whether NAP debtors may otherwise have entered repayment alternatives.

We recommend that further evaluative work is undertaken to gain a full and accurate picture of the costs and benefits of the legislation.

Unintended outcomes

Table 6 shows that NAP is somewhat more cost-effective for MED to administer, but also that NAP has had significant unintended costs and unintended consequences across other parts of government and the private sector.

Firstly, there have been significant unintended costs in the administration costs of NAP. Secondly, the extent of the debt write-off under NAP is notable. While write-off costs were intended as part of the NAP legislation, creditors suspect that the ease of NAP has attracted additional people who would otherwise have paid off their debts over a period of time. There appears to be the unintended consequence of NAP promoting moral hazard in insolvency cases – that is, that NAP provides debtors with the means to easily write-off debt, rather than take the more difficult route of longer-term repayment and better financial management.

We recommend further work by policy teams to investigate how these costs and consequences could be mitigated by amendments to the legislation.

Table 6: An example of costs and savings of NAP per year (from 2009/10 data)

Vote	Anticipated costs	Anticipated savings	Estimated actual costs in 2009/10	Estimated actual savings
Commerce	$0.25m (additional debtors attracted to NAP)	Efficiency savings	Approx $0.41m[23]	1.5 FTE p/y if all NAP debtors had been bankrupts Plus efficiency savings of 3 FTEs p/y
Social Development	$0.2m (increased debtors studying)	None	Unknown	None
	None estimated (debt written-off by NAP beneficiaries)		1502 x average beneficiary's NAP debt c. $6m (est included in direct cost to creditors below)	None
	None estimated		Unknown administration costs	
Inland Revenue	None estimated	$1.9m (reduced student loan write-offs)	Unknown administration costs	c. $2.05m[24]
	None estimated		Unknown debt written-off (included in direct cost to creditors below)	
Costs to creditors	None estimated		Direct costs of c.$64.1m[25]	
			Unknown administration costs	
Totals	$0.45m	$1.9m Plus efficiency savings	Direct costs of $64.1m Plus unknown significant administration costs to state and private sector	c. $2.05m Plus efficiency savings of 4.5 FTEs p/y

[23] Based on relevant time-units for total numbers of accepted, rejected and terminated NAP applications for the 2009/10 year, multiplied by an average FTE estimate of $83,000 (including overheads and benefits).

[24] Based on Inland Revenue data reported in the Dominion Post on 19th May 2011 that the median student loan balance is $11,900; multiplied by 172 NAP debtors who were also students in 2009/10.

[25] Based on the number of NAP debtors for 2009/10, multiplied by the average NAP debt written off of $21,182.

Appendix A

INSOL International Consumer Debt Report: Report of Findings and Recommendations, *INSOL International*, 2001

Principles and Recommendations

The principles that underlie the resolution of consumer debt problems are:

Principle 1: Fair and equitable allocation of consumer credit risks.

Principle 2: Provision of some form of discharge of indebtedness, rehabilitation or "fresh start" for the debtor.

Principle 3: Extra-judicial rather than judicial proceedings where there are equally effective options available.

Principle 4: Prevention to reduce the need for intervention

To achieve these principles, the following actions are recommended.

Legislators should:

- Enact laws to provide for a fair and equitable, efficient and cost effective, accessible and transparent settlement and discharge of consumer and small business debts.
- Provide for appropriate alternative proceedings depending on the circumstances of the consumer debtor.
- Consider providing for more appropriate separate or alternative proceedings for consumer debtors.
- Ensure that consumer debtor insolvency laws are mutually recognised in other jurisdictions and aim at standardization and uniformity.
- Offer the consumer debtor a discharge from indebtedness as a method of concluding a bankruptcy or rehabilitation procedure.
- Encourage the development of extra-judicial or out-of-court proceedings in order to resolve the problems of consumer debts.

Governments, semi-governmental or private organisations should:

- Ensure the availability of accessible, sufficient, competent and independent pre and post bankruptcy debt-counselling.
- Set up voluntary educational programmes to improve information and advice on the risks attached to consumer credits.

Lenders should:

- Review the way credit is made available to consumers and small businesses, information is presented and the way these debts are collected.

Organisations of lenders and consumers should:

- Set up methodologies to monitor consumer loan delinquencies and to make recommendations on such matters including the need for safeguards on privacy.
- Make reliably accurate credit reporting and scoring information available to individuals.

Appendix B

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