Fit for purpose consumer credit legislation

DISCUSSION DOCUMENT – MAY 2024

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Te Kāwanatanga o Aotearoa
New Zealand Government

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Ministry of Business, Innovation and Employment (MBIE)
Hīkina Whakatutuki – Lifting to make successful

MBIE develops and delivers policy, services, advice and regulation to support economic growth and the prosperity and wellbeing of New Zealanders.

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How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by **5pm on 19 June 2024**.

Your submission may respond to any or all of these issues. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please use the submission template provided at: *https://www.mbie.govt.nz/have-your-say/fit-for-purpose-financial-services-reform*

This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission:

- By sending your submission as a Microsoft Word document to *consumer@mbie.govt.nz*
- By mailing your submission to:

  Consumer Policy
  Building, Resources and Markets
  Ministry of Business, Innovation & Employment
  PO Box 1473

  Wellington 6140
  New Zealand

Please direct any questions that you have in relation to the submissions process to *consumer@mbie.govt.nz*.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process and will inform advice to Ministers on potential reforms to financial markets conduct requirements. We may contact submitters directly if we require clarification of any matters in submissions.

Release of information

MBIE will publish the submissions on our website at www.mbie.govt.nz.

Submissions may be subject to release under the New Zealand Official Information Act 1982 and requests under the Privacy Act 2020.

Official information

Submissions may be requested under the Official Information Act 1982. If you have any objection to the release of any information in your submission, please set it out clearly in your submission.

Please clearly indicate which parts you consider should be withheld, together with the reasons for withholding the information and the grounds under the Official Information Act 1982 you believe

apply. We will take such objections into account and will endeavour to consult with submitters when responding to requests under the Official Information Act 1982.

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The Privacy Act 2020 governs how we manage personal information (e.g., collection, use, holding, disclosure, etc.). Any personal information you supply to us in the process of making a submission for this consultation will only be used for the purpose of assisting in the development of policy advice in relation to this review, to attribute submissions or for contacting you about your submission. We may also use personal information you supply in the course of making a submission for other reasons permitted under the Privacy Act 2020 (e.g. with your consent, for a directly related purpose, or where the law permits or requires it).

Please clearly indicate in the cover letter or email accompanying your submission if you do not wish for your name, or any other personal information, to be disclosed in any summary of submissions or external disclosures. You have rights of access to and correction of your personal information as explained on the MBIE website at www.mbie.govt.nz. If you include the personal information of another individual in your submission, they also have the right to access and/or correct of their own information.

Other information

If there is other information that you would like to submit to MBIE for consideration in this consultation but do not want it publicly disclosed, please do clearly set that out in your submission for MBIE to consider.

Glossary

BNPL	Buy now pay later
CAP	Christians Against Poverty
CCCFA	Credit Contracts and Consumer Finance Act 2003
CoFI Act	Financial Markets (Conduct of Institutions) Amendment Act 2022
Commission	Commerce Commission
Cost of credit or cost of borrowing	In relation to a consumer credit contract, means any or all the following costs: a credit fee, a default fee and interest charges
Default fees	Fees or charges payable on a breach of a credit contract by a debtor or on the enforcement of a credit contract by a creditor
FCA	Financial Conduct Authority (UK)
Financial hardship	When a consumer is unable to meet their debt payments, bills, and/or essential living expenses
FMA	Financial Markets Authority
FMA Act	Financial Markets Authority Act 2011
FMC Act	Financial Markets Conduct Act 2013
FMC Regs	Financial Markets Conduct Regulations 2014
High-cost lenders	Lenders who charge an annualised interest rate of over 50 per cent per annum.
Interest rate	A charge that accrues over time and is determined by applying a rate to an amount owing under a credit contract (and includes a default interest charge)
Loan advance	A transfer of value from lender to borrower that is the amount of the loan extended to a borrower
MBIE	Ministry of Business, Innovation and Employment
Minister	Minister of Commerce and Consumer Affairs
MSD	Ministry of Social Development
Rate of charge	Rate of the costs of borrowing, excluding default fees
RBNZ	Reserve Bank of New Zealand
Total cost of credit	The total amount that a borrower must pay for credit over the course of the loan
UK	United Kingdom

Introduction

Context of financial services reforms

1 The Government is reforming the regulatory landscape for financial services in two phases. The objectives of the reform are to:
   a. simplify and streamline regulation of financial services (including reducing duplication)
   b. remove undue compliance costs for financial markets participants
   c. improve outcomes for consumers.

2 Phase One focuses on:
   a. revoking prescriptive affordability requirements and outdated exemptions from regulations made under the Credit Contracts and Consumer Finance Act 2003 (CCCFA)
   b. exempting voluntary targeted rates schemes from being consumer credit contracts and removing duplicative reporting requirements from regulations made under the CCCFA
   c. aligning certain rules for different financial dispute resolution schemes.

3 Phase Two focuses on:
   a. transferring regulatory responsibility for the CCCFA from the Commerce Commission to the Financial Markets Authority (FMA)
   b. reforms to address other known problems with the CCCFA, such as the liability settings for directors and senior managers
   c. examining the effectiveness of the CCCFA's high-cost credit provisions
   d. a targeted review of the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI Act) and other conduct requirements under the Financial Markets Conduct Act 2013 (FMC Act) and Financial Markets Authority Act 2011 (FMA Act)
   e. improving consumer access to and effectiveness of the financial dispute resolution system.

4 To enable consideration of these issues, the Government is releasing a package of discussion papers. You may wish to respond to one or more of the papers. The three papers are titled:
   a. Fit for purpose consumer credit legislation (this paper).
   b. Fit for purpose financial services conduct regulation.
   c. Effective financial dispute resolution.

What does this discussion paper do?

5 This discussion paper has three parts:
   a. Part 1: Options to amend the CCCFA to enable the FMA to carry out its role effectively.
   b. Part 2: Options to amend disclosure requirements of a credit contract.
   c. Part 3: Review of the high-cost credit provisions under subpart 6A of the CCCFA.

Criteria for review

6 Considering the Government's objectives discussed in paragraph 1, the options in each Part will be assessed against the following criteria:
   a. Effectively protects the interests of consumers
   b. Ensures regulatory burden/compliance costs are proportionate
   c. Promotes fair, efficient and transparent markets for credit among other financial services.

Process and timeline

7 Submissions on this paper close at 5pm on 19 June 2024. Following this, we will review the feedback and make recommendations to the Minister of Commerce and Consumer Affairs, with a view to introducing amendment legislation before the end of 2024. It is expected that legislation will be passed no earlier than Q3 2025.

1. Options to amend the CCCFA to enable the FMA to carry out its role effectively

Context

8 As part of a package of financial services reforms, Cabinet agreed to transfer regulatory responsibility for the CCCFA from the Commission to the FMA.[1]

9 This change is intended to simplify and streamline the regulatory landscape, refining New Zealand's 'twin peaks' approach to regulation for financial services. Under this model, the FMA will become the single regulator for financial markets conduct.

10 The Government's view is that moving to a more risk-based approach will better support both the provision of credit and compliance by lenders. In this part we are considering whether liability settings for directors and senior managers should be adjusted and how the regulation of credit contracts and consumer credit could or should align with the financial markets conduct regulation.

11 The discussion document *Fit for purpose financial services conduct regulation* seeks feedback on options to streamline conduct regulation and to ensure a clearer and more effective twin peaks model for financial regulation.

A. Options for liability settings

Background

12 Directors and senior managers have a duty under section 59B of the CCCFA to "exercise due diligence to ensure that the creditor complies with its duties and obligations under this Act." They can be held personally liable for breach of the due diligence duty. Their liability for pecuniary penalties cannot be indemnified or insured against. Similar (but not identical) restrictions on indemnity and insurance are found in the FMCA.

Problem/opportunity

13 While these settings were intended to increase accountability for directors and senior managers, we have also seen signs of them causing lenders to take highly conservative interpretations to requirements relating to affordability and a reluctance to exercise discretion as intended.[2]

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[1] EXP-24-MIN-0010, ***https://www.mbie.govt.nz/dmsdocument/28286-progressing-financial-services-reform-minute-of-decision-proactiverelease-pdf***

[2] MBIE, *Early implementation and impacts of 1 December 2021 credit law changes*, ***https://www.mbie.govt.nz/dmsdocument/23262-early-implementation-and-impacts-of-1-december-2021-credit-law-changes***

14 To the extent liability results in more conservative lending practices than intended, it has the potential to increase costs (which are generally passed on to consumers), reduce appropriate access to credit, and inhibit innovation.

15 Some larger lenders have suggested they are disproportionately affected by this issue.[3] Their directors and senior managers are more removed from their company's dealings with consumers. In a large bank, for example, the director has less direct control over the activities of employees, accountability passes through more layers of decision-making, and this may mean greater risk-aversion is built into their systems and procedures.

1.	Do you have any evidence or experience of the due diligence duty and personal liability resulting in overly conservative approaches to complying with the CCCFA? What impact did this have on consumers? How common do you think this is?
2.	Do you have any observations about how the impact of the due diligence duty and personal liability works may or may not depend on the size of the lender?
3.	Are you aware of any other problems with these liability settings?

Option A1 – Retain the due diligence duty but remove restrictions on indemnities and insurance

16 This option is to preserve the current due diligence duty and attendant liability for directors and senior managers.

17 We understand that failure of a director or senior manager to exercise due diligence would be typically identified only once some other breach of the CCCFA occurs. Whether this occurred despite due diligence by that person is then considered. To mitigate issues for overly conservative lending practises, under this option we would propose to:

a. enable lenders to indemnify their directors and senior managers for any pecuniary penalties awarded for a breach of the due diligence duty (and costs of proceedings with that result) (i.e., remove restriction on indemnities under section 107D). This would allow those costs to be met by the company rather than the director or senior manager personally; and

b. enable senior managers and directors to insure themselves against liability for pecuniary penalties (and costs) arising from a breach of the due diligence duty.

18 Indemnity, on its own, seems unlikely to address cases of overly conservative lender decision-making given it does not change the lender's exposure to liability overall. However, we are interested to understand how it might influence lenders' attitudes to compliance. Insurance would seem to redistribute the lender's costs/liability rather than reduce them. Therefore, as

[3] However, the expectations the duty places on individuals are proportionate to the nature of their responsibilities, the nature and size of the firm. Moreover, the quantum of any pecuniary penalties is required to be proportionate to the harm caused by the contravention.

with indemnity, we are interested in how the availability of insurance might influence lenders' tolerance for risk and attitudes to compliance.

4.	If lenders were able to indemnify their directors and senior managers from liability for pecuniary penalties (and costs), what difference (if any) would you expect that to make to how those individuals and the company as a whole approach the due diligence duty?
5.	If insurance were available for pecuniary penalties liability, what difference (if any) would you expect that to make to how directors and senior managers and the company as a whole meet their due diligence duty? Do you have any information about how affordable that insurance might be for different types of lenders?

Option A2 – Remove due diligence duty for licenced lenders

19 An alternative option would be to remove the due diligence duty for licensed lenders, that is, either:

a. *Consumer credit lenders who have been licensed under the CoFI Act (banks, non-bank deposit takers and licensed insurers)* – The rationale is that although the CoFI Act obligations are not a perfect substitute for the due diligence duty in the CCCFA[4], they do mean that financial institutions are subject to greater conduct regulation and scrutiny over the products and services they provide to consumers than other lenders. Withstanding that scrutiny, as well as that involved in prudential regulation by the RBNZ, requires relatively good governance, sophistication and investment in the market.[5] We understand there are currently 32 banks and non-bank deposit-takers offering consumer credit.

b. *Licensed consumer credit lenders (refer to proposal under option B1)* – The rationale is that it would be possible to rely on that licensing process and ongoing supervision, instead of the due diligence duty, to ensure the lender is capable of effectively and lawfully providing the service of being a creditor under a credit contract.

20 Where the due diligence duty was removed, directors and senior managers could still be held liable where they were knowingly or deliberately involved in a contravention (Section 93(d) and 107A(1)(c)–(f)).

21 The main downside with removing the due diligence duty for lenders licensed under the CoFI Act and the Deposit Takers Act is that it risks giving financial institutions a competitive advantage over other lenders in respect of non-mortgage lending. It is unclear to us how material any advantage would be in practice, given the duty only ensures particular individuals are involved in managing compliance with the CCCFA.

[4] A fair conduct programme requires policies, processes, systems and controls to treat consumers fairly, while the CCCFA due diligence duty requires directors and senior managers to ensure appropriate procedures are in place to comply with the Act.

[5] The due diligence duty in the Deposit Takers Act s93 is similar to the duty in the CCCFA in respect of prudential obligations. This is relevant given the RBNZ's controls on mortgage lending, which serve both prudential and conduct regulatory ends.

22 If the due diligence duty was removed for consumer credit lenders under a licensing model, we expect this to involve a trade-off between our criteria:

a. A licensing model may prove more effective at overseeing and promoting responsible in the consumer credit market. This may assist with right-sizing the compliance burden and better protect the interests of consumers. Though, this may depend on the size/organisational structure of the lender. For example, a due diligence duty may be more effective than licensing where the director or senior manager is more directly involved in lending decisions.

b. However, considering whether lenders are capable of effectively providing the service under the CCCFA as part of a licensing model rather than in response to allegations of a breach may increase compliance costs and inhibit entry into the market.

23 Both these impacts of the option would depend on the approach the FMA takes to assessing lenders' capability to effectively provide the service of being a creditor under a credit contract.

6.	Do you agree that the due diligence duty is less likely to be needed for lenders who are sophisticated enough to be licensed under the CoFI Act? Why/Why not?
7.	How well do you think licensing and ongoing supervision by the FMA could replace the need for due diligence and personal liability? Does this depend on the kind of lender? If so, how?
8.	What impacts might options A1 and A2 have on lenders and consumers compared to the status quo? For lenders, how would you expect lender decision-making and compliance cultures to change under these options?

Option A3: retain the status quo

24 One option is to retain the current settings for personal liability for directors and senior managers discussed above.

25 As the duty and liability for directors and senior managers have only been operating since December 2021, it is difficult to know to what extent they have improved compliance and protected consumers.

26 We would not expect a significant change to overly conservative lending practises, even with a shift in the regulatory approach discussed later in this part.

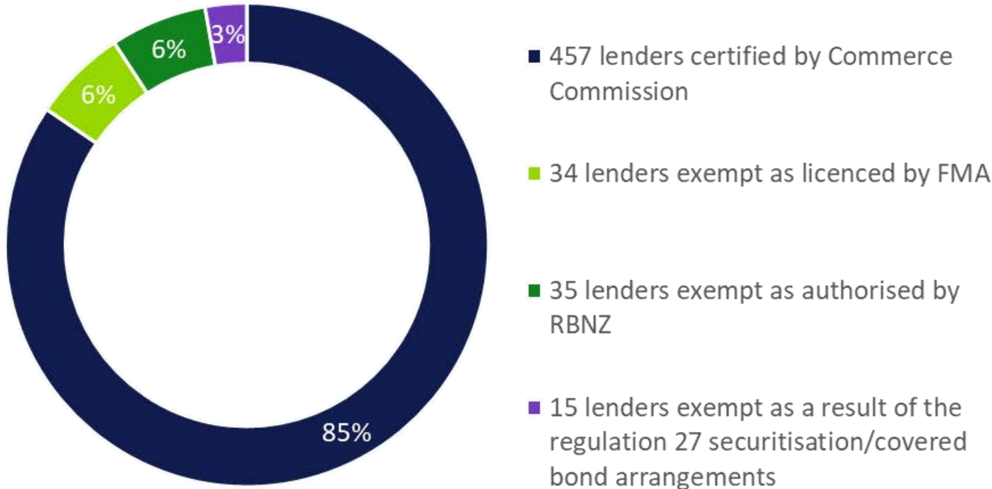
B. Options for regulatory model

Background

27 The 2019 reforms introduced a certification regime to the CCCFA to improve compliance. Creditors under a consumer credit contract and mobile traders must be issued certification by the Commission if their directors and senior managers are fit and proper persons to hold their respective positions. The intention was to reduce the operation of irresponsible and predatory lenders in consumer credit and to reduce irresponsible lending and phoenix lenders.

28 There are currently 457 lenders certified by the Commission (see Figure 1). The Commission can impose conditions relating to the fit and proper criteria at any time after certification is issued (section 131L in the CCCFA). Certification expires within five years, when lenders will have to reapply.

Figure 1: Consumer credit lenders who are certified vs those who are exempt



Problem/opportunity

29 There is an opportunity to look at regulatory settings between credit and conduct regulation with credit regulation transitioning to the FMA. In particular, whether credit should continue to have a different regulatory model than all other financial services. There are licensing requirements for most core retail market services under the FMC Act, such as providing financial advice.

30 In addition, the Commission and the FMA have different regulatory powers, some of which are attached to the regulatory model. There is an opportunity to look at what tools the FMA should have to be effective in its regulatory function.

31 Table 1 below provides an overview of the current regulatory models.

Table 1: Overview of current regulatory models

CCCFA (CURRENT)	FMC ACT (CURRENT) / INCL. COFI ACT (COMING)
Creditors' directors and senior managers must be certified as 'fit and proper' persons by the Commission every 5 years, unless exempt. These individuals must prove that they are financially sound, honest, reputable, reliable, and competent to perform their role. Creditors are exempt from certification if they are already licensed, registered, authorised, or otherwise approved to provide a licensed service by the FMA or RBNZ (CCCFA section 131C). The Commission's graduated enforcement model ranges from education and advocacy, warning letters and through to civil or criminal prosecution and pecuniary penalties. There are also a range of remedies, including damages. The Commission's tools under the CCCFA usually require them to apply to the Court first.	Certain providers of market services are required to be licensed by the FMA. Licensing requires: • registration on the FSPR, • Meeting three tests: the applicant's directors, senior managers and proposed directors and senior managers are fit and proper persons to hold their respective positions; the applicant is capable of effectively performing that service (having regard to the proposed conditions of licence); there is no reason to believe that the applicant will not comply with the market services licensee obligations and • meeting any other prescribed eligibility criteria for certain financial services. There is an ongoing regulatory relationship between the licence holder and regulator. FMA's regulatory model has core powers to issue direction and stop orders, and seek pecuniary penalties. The FMA also has broader powers for those required to hold a licence. Licensing allows targeted monitoring and supervision, and involves being able to set conditions, require annual returns and suspend or terminate the license. Regulatory tools also include action plans and censures. The FMA's licensing powers are flexible and proactive and do not require going to Court.

32 The current minimum regulatory changes that we see as necessary for the transition of consumer credit to the FMA are:

a. FMA being able to use its powers in respect of consumer leases and buy-back transactions

b. stop orders and direction orders to address fair dealing misconduct, and an extension of the restricted communication stop order ground for non-compliant CCCFA disclosures (as defined in s464 FMCA). This would enable the FMA to make a stop order for non-compliant CCCFA disclosures either banning distribution of the relevant document or prohibiting the person from supplying financial services while the order is in force.

c. enabling the FMA's general information-gathering and enforcement powers, and the regulation making powers relating to financial markets participants for fees, charges costs, and levies

d. extending the powers to make exemptions and designations to the FMA[6] and

[6] Exemptions to be made by regulations: ss545 and 546. Exemptions made by the FMA: s556. FMA exemptions last up to five years. Exemptions made under regulations do not have to have an expiration date.

e. streamlining duplicated powers and processes between the CCCFA, FMCA and the FMA Act (for example, the CCCFA provisions in s113 and replace s98A compliance orders with FMA direction orders).

33 This will allow the FMA to:

a. address fair dealing misconduct rules instead of the Commission under the FTA (FMC Act Part 2)
b. help right-size the compliance burden for lenders, avoid unnecessary overlap, and make the regulatory landscape clearer and more consistent
c. use its general enforcement liability power act faster, streamline enforcement processes and reduce some administrative costs.

34 These would apply in respect of both options discussed below.

9.	Do you agree that these are a fair reflection of the minimum legislative changes that are required to transition consumer credit to the FMA? If not, please explain why.

Option B1: Transition to a market services licence and apply all FMA core and licensing powers to consumer credit (preferred)

Market services licence

35 This option would require all consumer credit lenders to obtain a market services licence for consumer credit. Licensing enables the FMA to look at capability of effectively providing the financial service. Once licensed, lenders will have some reporting obligations under the FMC Act, and there would be the potential for licence conditions (FMCA, sections 402-406). Licence conditions allow the FMA to shape or uplift market conduct at a class or individual level.

36 This option would help to create a fair, efficient, and transparent market for consumer credit among other financial services as it aligns consumer credit with other market services regulated by the FMA. It would also align New Zealand with Australia and the UK, which both have specific regulatory approvals similar to licencing for consumer credit lending. If consumer credit were not regulated in the same way as other market services, there is a risk that markets would be less fair, transparent, and efficient.

37 Licensing has higher conduct expectations than certification, as it includes assessment of the lender’s capability to perform the market service. However, licensing applications are a one-off process, as opposed to the current 5-year certification process under the status quo. Actual or perceived regulatory burden to apply for the licence and/ or ongoing requirements may mean that some lenders choose to leave the market or just provide wholesale, or business credit (which we are not proposing would require a licence). Should this occur, this could mean less competition between consumer credit lenders, and less diversity of choice for consumers.

38 The extent of regulatory and compliance burden depends on design and implementation, such as the level of scrutiny of licence applications and the design of standard conditions which could mean lower compliance costs. In addition, the Government is considering shifting to a single licence, discussed in the *Fit for purpose financial services conduct regulation* discussion

document. A credit licence could be included in a single licence, which may mitigate any increased costs for those that already hold other market services licences.

39 To implement this option, we propose that existing consumer credit lenders could be automatically granted a transitional licence from a certain date specified in the legislation. This could be on the basis that they have passed the fit-and-proper person test (or are otherwise exempt) and that this remains current. The FMA would have access to its licensing powers in its regulatory toolkit during this transition period, so all interventions would be available to FMA as if consumer credit lenders were already licensed. We are interested in understanding what the implications of this would be.

40 Following the end of the transitional period, consumer credit lenders would have to obtain a full 'licensed market service' licence covering credit under Part 6 of the FMC Act to align with conduct regulation under the FMC Act.[7] We seek your feedback on what transition period would be appropriate.

Apply all FMA core and licensing powers to consumer credit

41 Market services licensing would give the FMA access to its licensing powers from its toolkit. This is because obligations under the CCCFA will become market services licensee obligations. This will enable the FMA to proportionately regulate and respond to shape market conduct, particularly as FMA's licensing powers are administrative tools that do involve court orders. Broadening the availability of stop orders for breaches of the CCCFA could also be considered under this option.

42 A licensing model protects the interests of the consumers by ensuring the FMA can proportionally monitor and promote compliance and responsible lending practices. It could ensure lenders demonstrate compliance with responsible lending obligations earlier than it would otherwise be required under the status quo. This could reduce instances of consumer harm as the regulator has more scope in their regulatory toolkit to be proactive.

43 Providing the FMA access to its licensing powers for consumer credit, and other regulatory tools (listed above at paragraph 33) in respect of all credit, would allow the FMA to undertake proportionate market conduct interventions. This in turn would provide lenders with confidence to do business. An environment where businesses can operate with confidence that enforcement will be proportional should improve innovation and competition.

10.	What implications would you expect adopting a licencing approach and the associated regulatory tools for consumer credit?
11.	What modifications to the FMA's existing regulatory tools, such as stop orders, should we consider if extending them to the CCCFA under this option?

[7] This approach would be similar to the approach in the Financial Services Legislation Amendment Act 2019, which used a three-year transition period before bringing in full licencing for financial advice providers.

12.	What do you think about the transitional licence approach, including what time periods are appropriate?

Option B2: Retain 'Fit and proper' certification (status quo) and add FMA core tools for enforcing the regulatory perimeter

'Fit and proper certification'

44 Under this option, consumer lenders who are not exempt as already licensed by the FMA or RBNZ would continue to apply to the regulator (which will be the FMA) for certification that their directors and senior managers are fit and proper persons to hold their positions, every 5 years, unless exempt.

45 In relation to the criteria, a certification model has benefits in that the lower entry barriers for most lenders make it easier for new consumer creditors to enter the market. This can enable innovation and diversity within the sector through competitive pressures, potentially meaning that borrowers have more lending options and credit products that meet their needs. However, this needs to be balanced with the potential for less sophisticated entities to be operating, who are less aware of their responsible lending obligations.

46 There will be inefficiencies for lenders and the FMA if a certification model is retained. This is because lenders that are not exempt would need to go through the certification process every 5 years and consumer credit would be out of step from other financial products and services, which use a registration and licencing model.

Retain CCCFA tools and add FMA core tools for enforcing regulatory perimeter

47 Under this option, the current CCCFA toolkit would be largely retained, with necessary legislative adjustments outlined at paragraph 33.**Error! Reference source not found.** to enable t he FMA to monitor and enforce the CCCFA rather than the Commission.

48 This option will allow the FMA to be reasonably responsive in its regulation, given powers such as direction orders and stop orders don't require an application to court, compared to powers such as compliance orders which is currently available under the CCCFA. Currently, FMA direction orders have a wide scope, while stop orders have specific provisions they are attached to (FMCA, sections 462 and 468). However, the scope of direction orders and stop orders proposed under this option is narrow, which can limit the FMA's responsiveness.

49 The scope, and FMA's standard process and ability to impose terms and conditions for exemptions and designations will be able to create a more efficient and somewhat proportionate regulatory system compared to under the current CCCFA, providing some additional flexibility for the FMA.

13.	Do you agree with our analysis about the relative benefits and risks of the certification model? Why/why not?
14.	Are there additional tools that you consider the FMA should have to regulate credit, for examples tools like action plans or censures that are usually only available under a licensing model?

Proposal: Proceed with Option B1 (transition to a market services licence and apply all FMA core and licensing powers to consumer credit)

50 The preferred preliminary view is to transition to a market service licence for consumer credit over time, with the associated licensing toolkit. This would be in addition to the minimum changes outlined at paragraph 33. We consider that this option best meets the Government's objectives when compared to the status quo, as this would align consumer credit with other market services regulated by the FMA and simplify the regulation of financial services.

2: Options to amend disclosure requirements

Context

51 One way the CCCFA protects the interests of consumers is by imposing requirements on lenders to disclose certain information to them. This is intended to reduce information asymmetries between consumers and lenders, and promote consumers' confident and informed participation in markets for credit.

52 The CCCFA also specifies what information must be provided, when information must be disclosed, how the disclosures are provided (section 35), and any exceptions when disclosure is not required.

53 The lender responsibility principles introduced in 2015 are also relevant to disclosure. They require lenders to assist borrowers to:

a. reach an informed decision whether to accept the credit
b. be reasonably aware of the full implications, and
c. reach informed decisions in all subsequent dealings (e.g. about changes to the agreement).

54 Failure to comply with the disclosure requirements or the lender responsibility principles relating to disclosure can give rise to criminal and civil liability (including forfeiting all interest and fees charged under the agreement in some cases).

C. Options for what and when information must be disclosed

Background

55 The CCCFA requires lenders to disclose particular information at certain times:

a. initial disclosure: before the loan is entered into
b. continuing disclosure: periodically throughout the loan
c. request disclosure: when the borrower asks for it
d. variation disclosure: when any terms of the loan are changed
e. transfer disclosure: when the loan is transferred to a new lender
f. guarantee disclosure: when the lender takes a guarantee
g. dispute resolution scheme and financial mentoring disclosure: when the borrower misses a payment or makes a complaint
h. disclosure about debt collection: before debt collection begins.

Policy problem/ opportunity

56 Lenders continue to raise several concerns with the nature of disclosure requirements and question their value to consumers. We accept the role of disclosure requirements as a form of consumer protection has been diluted somewhat by the creation of lender responsibility principles. We also accept that:

a. the amount of information disclosed may in many cases exceed what is relevant to the consumer's needs or ability to make informed decisions

b. the same information may be disclosed repeatedly on separate occasions, which is of questionable value to the consumer.

57 Lenders incur costs associated with the disclosure of information that may not always be material to a particular consumer's decision-making (with these costs likely being passed on to such consumers).

58 We have also heard concerns that the quantity or nature of information required to be disclosed can worsen rather than improve consumers' ability to understand the implications of their decisions or contract terms (for example, because the amount of information causes confusion or overwhelms consumers). Any evidence to support this claim would increase the case for reform.

Option C1: Maintain status quo

59 This option would retain the current CCCFA disclosure regime. All of the particular information required to be disclosed was selected because of its potential to be material to a consumer's decision(s). This option ensures consumers have access to that information in those cases, even if it is surplus to requirements in other cases.

Option C2: take a more targeted approach

60 If there is a reliable way to identify information that is more likely to be relevant to the consumer in view of their circumstances at the time of the disclosure, we would be open to targeting the requirements in the CCCFA accordingly. This could reduce the disclosure of unnecessary information and associated costs without affecting borrowers' ability to make informed decisions.

Option C3: Streamline and clarify information required to be disclosed without changing the approach

61 Another way we could achieve this is by reviewing the particulars of information required to be disclosed where there is evidence that information is unhelpful or unlikely to ever assist borrowers to reach informed decisions. This would involve more technical changes to disclosure requirements.

62 Under this option, we would be particularly interested in establishing issues with two disclosure requirements we have heard the most concerns about:

a. Disclosure before debt collection (section 132A) is perceived by some lenders as causing borrowers further distress or confusion. We would be interested in any evidence of issues with the information the CCCFA requires to be disclosed (as distinct from how it is disclosed).

b. We are aware there has been confusion over the details needing to be disclosed by sections 22 (disclosure of agreed changes) and 23 (disclosure of changes following exercise of power) of the CCCFA.

c. Regulation 4F in the Credit Contracts and Consumer Finance Regulations 2004 seems to have contributed to this confusion by suggesting the information it specifies should be disclosed in addition to the "full particulars" of change required by section 22. The intent was instead to clarify the meaning of the requirement to disclose "full particulars".

d. Regulation 4G in the Credit Contracts and Consumer Finance Regulations 2004 has not clarified enough what information must be disclosed and the meaning of "full particulars".

63 This option also has some limited potential to reduce compliance costs for lenders while ensuring borrowers have access to the information they need to make informed decisions.

15.	As a consumer, do you receive the right kind and amount of information to make informed decisions? Why/why not?
16.	Do you consider any of the disclosure obligations to be irrelevant, confusing or inappropriate? If so, please tell us what impact this has.
17.	How could disclosure obligations be more targeted to the consumer's circumstances to ensure only relevant information is disclosed?
18.	Is the information set out in Regulations 4F and 4G both sufficient and do sections 22 and 23 require the right information to be disclosed when a contract is varied?
19.	Are there any other concerns or issues you would like to raise related to disclosure obligations?

D. Options for how information must be disclosed

Background

64 Under section 35, the CCCFA provides for different methods of disclosure, namely:

a. giving the borrower the disclosure statement
b. sending the disclosure statement by post
c. sending the disclosure statement to the information system specified by the person for that purpose
d. sending an electronic communication to the information system specified by the person for that purpose
e. making the disclosure statement available in electronic form and sending an electronic communication to the information system specified by the person.

Problem/opportunity

65 The CCCFA enables lenders to use a range of methods of disclosure. However, it does require them to obtain their customers' consent for disclosures to be made in electronic form or via electronic communication (as stated in section 32(4)(b)). We understand most lenders have been able to capture consent through their terms and conditions.

66 Despite this, some lenders claim that the CCCFA still unnecessarily restricts the use of electronic methods for disclosing information. We are therefore seeking your feedback on any specific constraints the Act creates, and what impact these have.

Option D1: maintain status quo

67 Under this option, the methods of disclosure would remain unchanged, as well as the conditions attached to electronic methods of disclosure.

68 This option will not satisfy the lenders for whom the CCCFA restricts how disclosures are made.

Option D2: enable greater flexibility in disclosure methods

69 This option would be to provide greater flexibility by lifting the conditions related to electronic methods of disclosure, provided lenders inform their customers of how disclosures are provided.

70 Section 35(1) would continue to apply without the conditions set out in section 35(1A).

71 To the extent the CCCFA inhibits more efficient and effective methods of disclosure, we would expect this option to improve on the status quo against our criteria. However, electronic communication may not be suitable or user-friendly for borrowers who do not frequently use digital means of communication. This option may reduce those borrowers' ability to make informed decisions if it makes it more difficult for them to opt-out of electronic disclosure, or the lender chooses only to make disclosure electronically.

20.	As a lender, do you identify any barriers in the Act to the use of electronic methods of disclosure? If so, can you explain what are these barriers and how they impact your processes?
21.	As a lender, are there any practical difficulties with obtaining the borrower's consent for electronic forms of disclosure (section 32(4)(b))?
22.	What would be the implications of removing the requirement to obtain borrower's consent for electronic communication and forms of disclosure (section 32(4)(b))?

E. Options for penalties for incomplete disclosures by lenders

Background

72 If lenders fail to make proper disclosure to a consumer, a range of consequences can apply. These include prohibited enforcement of the contract, infringement offences, criminal convictions, statutory damages, compensation, refunds, and pecuniary penalties.

73 Section 99(1A) was introduced in 2015. It provides that lenders forfeit the right to any interest or charges for any period in which disclosure is not made under section 17 (initial disclosure) or section 22 (variation disclosure). This applies when a lender fails to make disclosure as required by sections 17 and/or 22, including by omitting any information those sections require.[8]

74 Section 99(1A) was introduced to ensure lenders do not profit from borrowing decisions that were based on incomplete information. However, some incomplete disclosures might not materially affect borrowers. Therefore, in 2019, section 95A was inserted to recognise that section 99(1A) could create significant financial liability that is out of proportion to the degree of harm caused to consumers. It allows lenders to apply to a court for relief from forfeiture of all interest and fees, if forfeiting them all would be considered disproportionate to the

[8] We note that s32, rather than s99, is relevant to cases where initial or variation disclosure contains an error that is likely to mislead.

seriousness of the breach (for example, if the breach was due to a reasonable mistake or due to events outside the control of the lender).[9]

75 This amendment did not have retrospective effect, in that lenders would only have the right to apply for relief under section 95A for incomplete disclosures after its commencement, in December 2019.

Problem/opportunity

76 Although section 95A can dilute its impact, the rationale behind section 99(1A) remains that an incomplete initial or variation disclosure entitles the borrower to a refund of their costs of borrowing until the omission is remedied. It assumes that a breach of the disclosure obligations (under sections 17 or 22) is automatically harmful to a borrower and that the harm is proportionate to its duration, which is questionable in some cases.

77 Banks have claimed that, even with sections 95A and 95B, section 99(1A) penalty may be disproportionate as they deal:

a. in much higher value loans, meaning that the loss of the interest and fees will be much greater than for other lenders; and
b. in significantly larger lending volumes. They have heavily automated systems which can increase the risk that an error or bug goes undetected for a long period of time, and that it affects a significant number of customers.

78 Disproportionate liability creates excessive risk aversion, which can result in lenders investing more in compliance than is justified by the interests of consumers. It could also threaten the financial stability of lenders in some cases.

79 When introduced, sections 95A and 95B aimed at:

a. reducing the risk of disproportionate and damaging financial impacts on lenders
b. setting an appropriate level of deterrence and penalisation for breaches of information disclosure obligations
c. eliminating the risk of over-compensation for borrowers
d. ensuring borrowers are entitled to an appropriate level of compensation
e. broadly balancing the ability of both borrowers and lenders to enforce their rights.

23.	Do sections 95A and 95B meet their objectives? Why/why not?
24.	As a lender, to what extent does section 99(1A) impact the time, effort, and costs you dedicate to initial and variation disclosures?

Option E1: Limit section 99(1a) to breaches that are material or have potential to mislead (preferred)

80 This option would limit section 99(1A) to cases where the omission or failure to disclose as required by section 17 or 22 is material or potentially material to the borrower's decision-

[9] See the list of factors that the court must have regard to for reducing effect of failure to make disclosure at s95B in the CCCFA.

making. How exactly this test is formulated would largely be a matter of drafting. However, we note a similar test is used in section 32(1)(d) (which relates to disclosure of incorrect information). This approach includes a 'potential to mislead' dimension as well as a materiality dimension.

81 A second-order question for this option would be which party should face the burden of proving whether or not the failure meets the chosen materiality test.

82 This option may create uncertainty for parties and enforcement challenges for borrowers, depending on the approach taken. Some of this uncertainty could be reduced if the regulator (which would be the FMA) issued guidance. If borrowers, or the regulator on their behalf, face the burden of proving the breach meets whatever test is chosen, this could deter them from using section 99(1A) to seek redress. This may limit the option's effectiveness in protecting consumers' interests. On the other hand, giving the lender the burden of proving the failure was not material may continue to result in disproportionate consequences.

Option E2: Limit on total liability under section 99(1A)

83 This option would be to cap the total amount that can be payable to borrowers affected by a single disclosure error under section 99(1A). This would ensure these errors do not threaten the existence or financial stability of lenders who make them.

84 We would need to consider how to set this cap. For example, it could be a fixed amount or a percentage of the lender's annual turnover (to avoid advantaging larger lenders).

Option E3: repeal sections 99(1A), 95A and 95B

85 This option would repeal sections 99(1A), 95A and 95B for breaches of section 17 and 22 that occur after the change. This would mean that a lender would no longer forfeit the interest and fees in case of non-compliant initial or variation disclosures. The other consequences of non-compliance would remain, including liability for statutory damages and an inability to enforce the contract (e.g. undertake debt collection).

86 However, this option would mean that there might have insufficient incentives on lenders to ensure compliance. We have heard from the Commission that some lenders only began paying due attention to their disclosure obligations because of section 99(1A).

Option E4: Retain the status quo

87 This option would keep the settings as they are, on the basis that the 2019 changes enable lenders to seek proportionate outcomes to breaches of disclosure requirements, whilst protecting consumers. However, this option is unlikely to meet the Government's objectives to reduce compliance costs while ensuring good consumer outcomes. This is because the current settings retain the onus on lenders to take court action to reduce their liability, which is costly.

25.	Under option E1, what should a materiality test look like?

26.	Under option E1, which party should have the burden of proof and what would this mean for the effectiveness of the option? If the onus is on borrowers to show materiality would that deter them from seeking redress under section 99(1A)?
27.	Under option E2, how should the maximum amount the lender forfeits be calculated?
28.	Under option E3, would there be the right incentives in place to ensure lenders comply with their disclosure obligations?
29.	What would be the risks associated with each option? How could they be mitigated?

Proposal: Proceed with Option E1 (limit section 99(1A) to breaches that are material or have potential to mislead)

88 The preferred preliminary view is to limit section 99(1A) to breaches that are material or have potential to mislead. We consider that this option best meets the Government's objectives to remove undue compliance costs where there is a mistake in disclosure that does not result in material harm to consumers. We are looking for views on which approach should be taken to defining the test and who should have the burden of proof.

3. Review of the high-cost credit provisions

Context

89 In 2020, the Credit Contracts Legislation Amendment Act 2019 introduced provisions that apply to high-cost consumer credit contracts to reduce problem debt by addressing the excessive cost of credit for these loans and repeat borrowing by vulnerable consumers.

90 The CCCFA defines a high-cost consumer credit contract as a contract:

a. that provides for an annual interest rate of 50 per cent or more, or
b. where the average interest rate is likely to be 50 per cent or more, or
c. where the combined annual interest rate and default interest rate are likely to be 50 per cent or more, or
d. declared by regulations to be a type of contract that is high-cost consumer credit contract.

91 Under subpart 6A the CCCFA, the high-cost credit provisions are:

a. The costs of borrowing must not exceed the loan advance (i.e. a borrower will never repay more than twice what they borrowed).
b. Lenders are prohibited from entering into a high-cost consumer credit contract with a consumer who:
   i. has an unpaid balance or has had an unpaid balance on any other high-cost consumer credit contract in the preceding 15 days
   ii. has entered into two or more high-cost credit consumer contracts in the past 90 days.
c. The rate of charge (including interest and fees but excluding default fees) for high-cost consumer credit contracts is capped at a maximum of 0.8 per cent per day.
d. Compound interest is prohibited.
e. There is a rebuttable presumption that default fees are unreasonable if exceeding $30 (or other prescribed amount, if any).

92 The Minister of Commerce and Consumer Affairs must, as soon as practicable after three years from commencement, review and report on the operation and effectiveness of the provisions[10], including exploring whether the interest rate that defines a high-cost consumer credit contract should be reduced to a rate between 30 per cent and 50 per cent.[11]

93 A review was undertaken as required by legislation (see Annex One). We found that:

a. The high-cost credit provisions have led to the elimination of the high-cost lending market. Out of the 21 high-cost lenders operating in March 2020, only nine remain, now operating as non-high-cost lenders. This has resulted in an estimated 150,000 potential borrowers who can no longer access high-cost loans. Former high-cost lenders have all either exited

[10] The review, as mandated by the CCCFA, focuses on subpart 6, which includes ss45E to 45K.
[11] Any requirements that apply to high-cost credit stated outside of subpart 6A of the CCCFA are considered out of scope of the review mandated by s45L of the CCCFA.

the lending market or restructured their products to not fall into the category of ‘high-cost loans’.

b. It is unclear what impact the high-cost credit provisions have had on debt spirals overall because the economic climate is likely muddying the data around arrears.

c. It is also unclear whether the removal of high-cost loans has led to financial difficulties. However, there has been a significant increase in BNPL use since the provisions came in and there has been no increase in the number of people accessing suggesting this has not been a significant issue.

d. Eliminating high-cost loans has reduced credit options for higher-risk borrowers. This might lead to individuals turning to more affordable sources of credit or struggling to cover expenses.

94 This section explores whether any changes to the high-cost provisions should be made, independently of the options identified in the preceding sections of this discussion document.

30.	What specific provisions (high-cost or other) have most impacted lenders’ willingness or ability to offer high-cost consumer credit?
31.	In the absence of high-cost loans, what other avenues are borrowers turning to?
32.	Is the unavailability of high-cost consumer credit having positive or negative effects on would-be borrowers?

Problem/opportunity

95 The high-cost credit provisions were implemented to tackle issues related to high-cost loans. These issues include frequent use of high-cost loans leading to financial harm, and debt spirals that can result in unmanageable debt and financial hardship.

96 However, it is still uncertain whether other types of credit are also contributing to debt problems. We are therefore seeking your feedback on whether any changes to the high-cost credit provisions are necessary to mitigate the financial harm caused by debt problems.

33.	What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 30 per cent to 49.9 per cent?

F. Options for changing the high-cost credit provisions

Option F1: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 30 per cent

97 Numerous submitters to the Credit Contracts Legislation Amendment Bill submitted that the definition of a high-cost consumer credit contract should be expanded to include contracts with an interest rate over 30 per cent. The statutory review requires the Minister to consider whether the interest rate that defines a high-cost consumer credit contract should be reduced to a rate between 30 and 50 per cent.

98 We are interested in evidence as to whether loans in this 30 per cent to 50 per cent range are:

a. resulting in an excessive cost of credit – whether due to the inherently high costs of borrowing, repeat borrower defaults, loan extensions, or other reasons
b. exhibiting similar rates of default to previous rates of default for high-cost loans.

34.	Are there any other issues associated with loans in the 30 per cent and 50 per cent interest rate range that we should be aware of?

99 Under this option, any consumer credit contract with an interest rate above 30 per cent would be classified as a high-cost credit consumer contract and would have to comply with the high-cost credit provisions.

100 We have received feedback from a former high-cost credit lender regarding this proposed reduction in the interest rate threshold. They have expressed concern that a reduction in the threshold without considering other changes to the high-cost credit provisions could make loans in the affected interest rate range uneconomic for lenders. According to this lender, it is not a specific provision, but the cumulative impacts of the high-cost credit provisions that made these loans unviable.

101 We seek feedback on what other changes to the provisions of high-cost credit may be desirable to enable loans in this 30 per cent and 50 per cent interest rate range to still be profitable.

35.	Are there examples where loans with interest rates between 30 per cent and 50 per cent would breach the 0.8 per cent rate of charge cap?

Potential impacts of lowering the threshold

102 The below diagram (Figure 2) shows the range of interest rates for different loan types. It helps visualise what proportion and types of loans would be defined as high-cost if the threshold is lowered to 30 per cent.

Figure 2 – Range of interest rates for different loan types[12]

103 We have identified 26 lenders which offer loans with a maximum interest rate between 30 per cent and 50 per cent. If the interest rate threshold is lowered, mainstream credit products will be categorised as high-cost credit (such as unsecured revolving credit facilities and bank overdrafts). Lenders will either have to reduce their interest rates to 30 per cent or comply with the high-cost credit provisions.

104 If we expect most products between 30 per cent and 50 per cent to remain profitable, access to credit may be reduced:

a. Lenders may reduce their loan terms to stay within the 100 per cent total interest and fee cap. This would increase repayment amounts, further reducing access to credit and price some borrowers out of the market for certain lending products.
b. Lenders may stop offering loans in the 30 per cent and 50 per cent interest rate range, as credit fees are high relative to small loans, loans in the considered range are likely to reach both the maximum rate of charge and total cost of credit cap more easily.
c. Loan products may be removed from the market if lenders find it too difficult to comply with the high-cost credit provisions. For example, former high-cost lenders identified difficulties for ascertaining whether a potential borrower has other existing or recent high-cost loans, would persist. As loans in the 30 per cent to 50 per cent range are generally for longer terms (compared to loans above the 50 per cent), it might be harder to ascertain from the outset whether specific types of credit are high-cost. For example, lenders would

[12] NBDT stands for non-bank deposit taker.

need to make a lot of assumptions to determine whether the high-cost credit provisions apply to revolving credit contracts with both default interest (for a breach of contract) and excess interest (for amounts over the credit limit).

Option F2: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 45 per cent

105 We could also look at lowering the threshold to another rate between 30 per cent and 50 per cent. For example, if we lowered the threshold to 45 per cent, this would capture the highest interest rates in the market.

Potential impacts of lowering the threshold

106 We have identified 13 lenders which offer loans with a maximum interest rate between 45 per cent and 50 per cent. If the interest rate threshold is lowered, our assumption is that there is less risk that borrowers will face financial difficulties due to loss of access to affordable loan products with lenders likely to drop interest rates under 45 per cent rather than remove products. However, it is likely to have only a marginal impact on reducing harm for borrowers.

Table 2 – Comparison of options for high-cost credit

	STATUS QUO: 50% THRESHOLD	30% THRESHOLD	45% THRESHOLD
Reduces financial harm to consumers from problem debt?	Problem debt from new high-cost loans has been eliminated.	Extends protections against excessive cost of credit and repeat borrowing to a greater number of borrowers.	Protections against excessive cost of credit and repeat borrowing extended to at least 13 lenders.
Does not restrict access to affordable credit?	Affected loan products from 21 lenders, which has eliminated high-cost market and reduced access to credit for estimated 150,000 borrowers.	Would affect loan products from at least 26 lenders. Some lenders may withdraw products.	Would affect loan products from 13 lenders. Lenders likely to simply drop interest rates by up to 5%, although some may remove products.
	Fewer options for small loan amounts as lenders who have remained in the market, have moved to larger, longer-term loans.	Lenders are likely to offer larger, longer-term loans, and/or to increase repayment amounts which may price some borrowers out.	We would expect lenders to maintain similar loan terms as under the status quo. As per the status quo, fewer options for borrowers wanting small loan amounts.
Compliance costs are reasonable?	Lenders have had difficulties identifying where customers have other high-cost loans for the purposes of repeat borrowing provisions.	As per status quo, lenders likely to have the same level of difficulty identifying other high-cost loans.	As per status quo, lenders likely to have the same level of difficulty identifying other high-cost loans.

36.	What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 45 per cent to 49.9 per cent? Are there any other issues associated with loans in this interest rate range that we should be aware of?
37.	For lenders: If the government extended the high-cost provisions to loans with annual interest rate of 30 per cent or more, what would be the impact on your operations (if any)? Are there any changes to the high-cost provisions we should consider to enable those loans to remain profitable, and on what terms?
38.	How is a revised definition of a high-cost consumer credit contract interest rate threshold likely to affect access to credit for borrowers?
39.	Do you recommend considering another interest rate threshold? If yes, please explain why.

Option F3: Status quo

107 Our review of the high-cost provisions found that they have been effective in safeguarding consumers from the harm caused by high-cost loans. Our analysis revealed that:

a. The total cost of credit cap has not been problematic for some former high-cost lenders as they had already implemented a voluntary 100% cost of credit caps prior to the introduction of the high-cost provisions, and as most loans would never reach this level in practice.

b. The daily rate of charge, which is currently capped at 0.8% per day, has made high-cost lending unprofitable for some lenders. However, increasing the rate would result in a higher maximum allowed annual interest rate, which goes against the primary objective of the provisions - to protect consumers from excessive interests.

c. The repeat borrowing provisions have been successful in curbing debt spirals caused by high-cost loans.

108 This option would therefore retain the current provisions in the CCCFA.

40.	Do you have any other feedback on any of the high-cost credit provisions? Have they been effective in reducing financial harm caused by the excessive cost of credit for some types of loans and repeat borrowing by vulnerable consumers?

Option F4: Other high-cost provisions

109 The option identified above are however not likely to address all problem debt. We have heard that motor vehicle finance can be a source of problem debt[13], because of excessive cost of credit (sometimes doubling, or more, the principal loan amount), add-on fees, the use of immobilising devices, and dealer commissions.

[13] One in five vehicle contracts that CAP reviewed required the borrower to repay at least double the vehicle price, even without payment defaults. CAP (2022). *Vehicle Finance: Lifting the bonnet on unethical practices*: https://www.capnz.org/wp-content/uploads/2022/06/Vehicle_finance_2022_f_UPDATED.pdf

110 While, typically, interest rates for vehicle finance are below 30 per cent, they can be higher.[14] Lowering the interest rate threshold to 45 per cent or to 30 per cent would not solve most of the above issues, as only a small subset of vehicle loans would be captured by the high-cost credit provisions. However, we are also interested in whether the CCCFA could be strengthened to protect consumers who are sold lending products/ add-ons that often exceed the value of the product (such as motor vehicle lending).

111 We have not considered the option of getting rid of the threshold altogether, or applying some (or all) of the provisions to a wider range of consumer lending under the CCCFA. The impacts of doing so would be much more widely felt and uncertain, and are likely to significantly disrupt consumer credit markets, with unintended consequences and reduced access to credit.

112 We are however interested in any feedback you might have on how high-cost credit provisions (while keeping the 50 per cent interest rate threshold unchanged) could be amended to address the issues identified.

41.	Is there evidence of certain industry lending practices that are causing harm which the high-cost credit provisions could address?
42.	Are there any other industry lending practices that you believe are harmful to consumers?
43.	Do you agree with the suggested impacts of each of the identified options? Why/why not?
44.	Do you have any information or data that would support our assessment of the impacts of each of the options?
45.	Do you think that the CCCFA could be strengthened to protect consumers who are sold lending products or add-ons that exceed the value of the product? If so, how?
46.	Finally, are there any other areas and options for change that we should consider that have not been addressed in this discussion document?

Proposal: Expand the definition of a high-cost consumer credit contract to contracts with an interest rate of above 30 per cent, while amending some other high-cost credit provisions (Option F1 and F4)

113 The preferred preliminary view is that this option will most effectively address excessive cost of credit and mitigate financial harm, and problem debt. However, we are looking for views on which approach should be taken to enable the loans in this 30 per cent and 50 per cent interest rate range to remain viable and ensure consumers can access affordable and responsible credit. This could include amendments to other high-cost credit provisions.

[14] A 2020 Commission survey of credit products found that the average maximum interest rate for motor vehicle loans was 21.8 per cent, with the highest being 45 per cent.

4. Limitations and constraints on analysis

114 This discussion document was prepared under time constraints which only allowed for limited consultation. The Minister of Commerce and Consumer Affairs has met with a number of industry representatives to discuss issues related to financial services regulation and a possible package of reforms. MBIE has carried out targeted consultation with the FMA, the RBNZ, Treasury, the Commerce Commission, the Ministry of Justice (offences and penalties team) and the MSD (consultation with MSD occurred on the statutory review of high-cost credit only). We have undertaken targeted consultation with industry and consumer advocates in preparing the statutory review of high-cost credit at Part 3 and Annex 1. This document functions as part of our consultation to inform policy decisions.

115 The options and analysis presented in this report are largely based on qualitative evidence of specific issues with the CCCFA based on limited stakeholder engagement. In addition, we have considered qualitative feedback from a small number of submitters provided during the 2018 consultation on changes to the CCCFA, including on the review of high-cost credit.

116 Given the objectives of the review, Parts 1 and 2 of this discussion document considered only the options which would simplify or clarify the CCCFA. It did not consider reworking or overhauling the key fundamental features of the CCCFA, as this is not the aim of the review.

117 The statutory review of high-cost credit requires the Minister to consider expanding the definition of high-cost credit to a rate between 30 per cent and 50 per cent interest rate per annum. For completeness, we are also consulting on other changes to other high-cost credit provisions that could complement an expanded definition or otherwise advance the Government’s objectives for these reforms.

Annex 1: Impacts of the high-cost credit provisions – statutory review

Limitations and assumptions

1. Our initial observations on the operation and effectiveness of the high-cost credit provisions are based on:
   a. credit market and borrower data
   b. evidence from consumer advocates, lenders and lender representatives
   c. compliance information from the Commission.

The use of high-cost loans before the high-cost credit provisions came into force

2. Prior to the introduction of high-cost credit provisions, some lenders offered small loans (from $100) over short timeframes (from one week to three months for most high-cost lenders) at high interest rate (from 100 up to 800%). These credit products were referred to as 'high cost' because of their high annual interest rates, compared with products offered by 'mainstream' lenders such as banks, and credit unions.

3. Despite the excessive costs implied by these loans, it was estimated that at least 150,000 consumers used high-cost lenders each year, for various reasons:
   a. Some borrowers wanted loans for short timeframes and small amounts (generally not available from "mainstream" lenders).
   b. Some borrowers could not obtain a loan elsewhere due to their credit histories.
   c. Some borrowers did not trust mainstream lenders, or found their processes too bureaucratic, impersonal, inconvenient, or slow.
   d. Some borrowers preferred the independence and privacy of a loan over seeking assistance from a charity, the government, family, or friends.
   e. Some borrowers were not aware of other options.

Were high-cost loans used for a specific purpose?

4. In 2019, high-cost lenders revealed the reasons why consumers applied for loans that were ultimately declined. [15] We however note that this only represents a subset of high-cost borrowers, and does not reflect the reasons for approved high-cost loans. Common purposes for taking out high-cost loans are shown in the table below.

[15] MSD, MBIE, Te Puni Kōkiri (2019). *The Safer Credit and Financial Inclusion Strategy.* ***https://www.msd.govt.nz/documents/what-we-can-do/providers/building-financial-capability/safer-credit-and-financial-inclusion/safer-credit-and-financial-inclusion-strategy.pdf***

Table 1 – Common purpose of taking out high-loans

MOST COMMON PURPOSE
• vehicle repairs (16 per cent) • food or groceries (9 per cent) • personal items, gifts, or leisure (9 per cent) • payment of debt (7 per cent) • transport (7 per cent) • mortgage/rent/board (7 per cent) • utility bills (6 per cent) • funeral costs (6 per cent) • maintenance/repairs (6 per cent).

Reasons for the introduction of the high-cost credit provisions

5 The high-cost credit provisions were introduced to address the following issues:

a. Financial harm from frequent use of high-cost loans: borrowers made substantial payments in interest and fees, making them more vulnerable to financial shocks.

b. Debt spirals: consumers who defaulted on high-cost loans, or sought loan extensions, were likely to result in unmanageable debt which accrued indefinitely.

c. Uncompetitive rates: interest rates and fees were viewed as "excessive" with a disjunction between most finance companies charging around 36 per cent per annum and high-cost credit lenders' rates ranging from 100-800 per cent per annum for a one week up to three months loan.

d. A disproportionate number of concerns about irresponsible lending related to high-cost credit lenders. High-cost credit lenders made up 24 per cent of CCCFA complaints to the Commission in 2016/2017.

Consequences of the high-cost credit provisions

Elimination of the high-cost lending market

6 We understand most high-cost credit lenders left the market before the high-cost credit provisions came into effect. Of the 21 high-cost lenders identified in March 2020, nine appear to still be operating. The rest have been deregistered from the Financial Services Providers Register and/or have ceased trading. As far as we are aware, none of the remaining lenders currently offer products with an annual interest rate of over 50 per cent.

7 Based on the UK and Australian experiences, we previously estimated that the number of consumers accessing high-cost loans would fall from around 150,000 per year to around 90,000.[16] Currently, no consumers are accessing new high-cost loans, meaning that an estimated 150,000 would-be borrowers no longer have access to these loans.

[16] MBIE (28 August 2019). *Review of consumer credit regulation – further policy recommendations.* https://www.mbie.govt.nz/assets/review-of-consumer-credit-regulation-further-policy-proposals.pdf

Table 2 – State of the high-cost lending market

<table>
<tr><td>21

High-cost lenders in March 2020</td><td>12

High-cost lenders that exited the lending market</td><td>9

Former high-cost lenders continuing to lend in 2024 but at interest rates below 50%</td><td>0

Lenders offering high-cost loans in 2024</td></tr>
<tr><td colspan="2">150,000

Estimated users of high-cost loans 2019</td><td colspan="2">0

Users of new high-cost loans 2024</td></tr>
</table>

8 The extent of this outcome was not anticipated, it was considered that high-cost lending should still be an option for consumers.[17]

9 Some former high-cost lenders have commented that the high-cost consumer credit rules made it uneconomic to offer high-cost loans, for various reasons:

a. One lender struggled to cover their costs due to the low 0.8 per cent daily rate of charge cap.

b. A former high-cost lender suggested that it was because New Zealand is the only jurisdiction to combine all three of the following restrictions: that fees must be cost-recovery only, the 0.8 per cent daily rate of charge cap and the 100 per cent total cost of credit cap.

10 If other provisions were seen as difficult to comply with (eg how to calculate the exact rate of charge, or checking if borrowers have other existing debts), taken in isolation, they did not make high-cost loans unprofitable, according to former high-cost lenders.

Change in products offered

11 Many former high-cost lenders have restructured their products so the maximum annual interest rate is just below 50 per cent, and so do not have to comply with the high-cost credit provisions. In 2019, 13 lenders offered a maximum annual interest rate of between 30 per cent and 50 per cent, and in 2023, the Commission was aware of at least 26 lenders offering loans in this range of interest rate.

Effect on levels of financial harm experienced by borrowers

12 One of the problems that the high-cost credit provisions sought to address was financial harm caused by debt spirals. Debt spirals can occur when a consumer defaults on or extends a loan, resulting in unmanageable debt due to the cumulative debt amount from high interest and fees.

[17] Hon Kris Faafoi, New Zealand Parliament (19 November 2019). Credit Contracts Legislation Amendment Bill – Second Reading. ***https://www.parliament.nz/en/pb/hansard-debates/rhr/combined/HansDeb_20191121_20191121_24***

13 We have observed that there are no longer debt spirals resulting from high-cost loans since the high-cost consumer credit sector was eliminated. However, debt spirals may still occur for other types of consumer credit.

14 In addition, one of our assumptions was that the withdrawal of high-cost loans should have theoretically resulted in lower costs of borrowing. However, as high-cost loans previously made up a small percentage of the overall New Zealand credit market, the effects of the withdrawal of high-cost lending on overall arrears is likely to be minor.

15 Prior to the changes, in 2019, FinCap, an organisation representing and coordinating financial mentoring services across the country, reported that over half of financial mentoring clients had accessed a payday loan in the 12 months prior.[18] Data from Christians Against Poverty indicates that there has been a steady decline in the total high-cost debt across clients falling from $227,000 in 2019 to $58,000 in 2023.

16 However, arrears levels have been tracking higher than prior to the changes, following historic lows mid-pandemic. In January 2024, personal loan arrears rose to 9.9 per cent, up 8 per cent compared to January 2023.[19] Nevertheless, this increase is likely to be a result of the wider economic climate.

17 If the personal loan default rate does not specify the characteristics of the defaulting individuals, Centrix data shows that the younger generation, specifically between the ages of 18 to 24, are the most affected by financial difficulties, as well as people residing in the Wairoa, Kawerau, and South Waikato districts.[20]

Reduced instances of repeat high-cost borrowing

18 The high-cost credit provisions include restrictions on lending to certain borrowers to prevent financial harm from repeat borrowing. Lenders are prohibited from entering a high-cost consumer credit contract with a consumer who has:

a. an unpaid balance on any other high-cost consumer credit contract, or has had an unpaid balance on any other high-cost consumer credit contract in the preceding 15 days

b. entered into two or more high-cost consumer credit contracts in the past 90 days (as high-cost consumer credit was designed for temporary rather than ongoing use).

19 As high-cost loans are no longer available, vulnerable borrowers are no longer able to borrow multiple high-cost loans. However, given the restrictions on repeat borrowing only apply to high-cost loans, it is possible for borrowers to have multiple non-high-cost loans.

20 FinCap has observed fewer instances of repeat borrowing amongst financial mentoring clients, but an increase in repeat buy now pay later (BNPL) debts.

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[18] FinCap (7 August 2019). *Supplementary submission 4 – Credit Contracts Legislation Amendment Bill.* https://www.parliament.nz/resource/en-NZ/52SCFE_EVI_86627_FE20751/5dbb41bab709b9ead96a45cfc47618d95d1eca06

[19] Centrix (February 2024). *Credit Insights Report*.

[20] Centrix (February 2024). *February Credit Indicator*

Reduced access to credit for riskier borrowers

21 We anticipated that the removal of high-cost consumer credit products would significantly limit access to credit for higher-risk borrowers with short-term difficulties. Higher-risk borrowers, who might be considered "sub-prime" (with credit scores below those served by mainstream banks), are estimated to comprise at least 30 per cent of the credit market.

22 There are different views about the impact that the elimination of high-cost consumer credit has had. A consumer advocate argued that the measures had not made affordable credit harder to obtain, as high-cost lending was generally considered as unaffordable due to the high interest rates.

23 High-cost loan borrowers often relied on high-cost loans to cover essential expenses or one-off emergency events. However, even in the absence of high-cost lending, people are still likely to require short-term, small amounts of credit. The question that arises is whether these individuals have turned to more affordable sources of credit, resulting in a better financial position than if they had accessed a high-cost loan, or if they are worse off because they have either not been able to cover such expenses, or are incurring greater costs to do so.

24 If the removal of high-cost consumer credit has resulted in more would-be borrowers experiencing financial difficulties, we would expect an increase in the number of clients accessing financial mentoring services.

25 However, FinCap has not seen a significant increase in the number of people accessing financial mentoring. In 2018, over 70,000 people accessed financial mentoring services,[21] decreasing to over 63,000 clients in 2021 and 50,000 in 2022.[22] Given it has been over three years since most high-cost lending has stopped, any corresponding increase in financial mentoring service uptake should have materialised by now.

26 The proportion of high-cost loans among financial mentoring clients' unique debt (who are likely to be vulnerable borrowers) was 1.8 per cent in 2021 and 2022. However, the percentages of debts from other sources like credit card, credit sale/hire purchase, motor vehicle loan, personal loan, and revolving credit facility have all increased in 2022.[23] This may indicate people are turning to other types of credit now high-cost loans are no longer available.

27 Options for those who no longer have access to high-cost consumer credit include:

a. other credit products eg longer-term, lower interest rate loans
b. BNPL
c. un-arranged overdrafts
d. no or low-interest microfinance loans
e. unofficial lending sources eg illegal lenders, or borrowing from family or friends
f. financial assistance from the government

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[21] As above footnote 18.

[22] FinCap (September 2023). *Voices: Indicators of financial wellbeing for whānau supported by financial mentors in 2021 and 2022*: **https://www.fincap.org.nz/wp-content/uploads/2023/09/230915-Final-Voices-report.pdf**

[23] As above footnote 22.

g. forgoing the good/service/payment etc for which the loan was wanted.

Take up of other credit products

28 The lenders we have talked to have not reported an increase in the take-up of longer-term loans. While personal loan enquiries are now above 2019 levels, application approval rates have declined.[24] While lenders may convert some former high-cost loan borrowers to larger, longer-term loans, lenders must also be mindful of responsible lending obligations. These include making reasonable enquiries to be satisfied that the credit is suitable and affordable for the borrower.

29 One lender noted that if a borrower only wants $400 to cover the cost of car repairs but can now only access a minimum $500 loan, they may add on other purposes to their loan application (eg paying off other bills) so that they can borrow $500 (thereby increasing the overall amount spent and, potentially, the costs of borrowing). This lender also suggested some borrowers experience "loan fatigue" – that is, customers who are used to having much shorter-term loans become frustrated at having to continue to make payments over a much longer timeframe.

30 Because small loans can be cost-intensive to administer, we found around 20 lenders, which may partially fill the gap left by high-cost lending, with loans products below $1000 (with some offering loans from as low as $100 or $200). The downside of these low-amount loans is the high establishment fees (sometimes up to $250 or $350).

31 However, the Minister recently announced a package of financial services reforms aimed at improving access to home loans and other types of lending. As part of these reforms, the Government is removing the detailed requirements for assessing the affordability of lending from the Credit Contracts and Consumer Finance Regulations 2004. The current prescribing one-size-fits-all approach has led to increased processing times, making small loans no longer profitable for many lenders. By allowing lenders to apply more discretion and flexibility when lending to credit worthy borrowers, this reform may lower the costs associated with administrating and providing loans, which could potentially incentivise mainstream lenders to expand their smaller loans offer.

Take up of buy now pay later

32 BNPL providers offer short-term loans with fixed payments and no interest. BNPL is an alternative to high-cost loans as it provides flexibility to spread out costs. The increase in BNPL use coincides with the elimination of high-cost lending.

33 Financial mentoring services indicated that people who are unable to meet their essential living expenses are now mostly turning to the array of BNPL providers.

[24] Centrix (September 2023). *Credit Insights Report*.

34 The number of BNPL debts for financial mentoring clients almost doubled in 2022 compared to 2021.[25] There has also been a significant increase in the number of new CAP clients presenting with BNPL debts coinciding with the drop in high-cost debt.

Table 3 – Buy Now Pay Later debt

2%	**25%**	**$317**	**$662**
Percentage of CAP clients with BNPL debt, 2019/2020	Percentage of CAP clients with BNPL debt, 2022/2023	Average total BNPL debt per CAP client for 2019/2020	Average total BNPL debt per CAP client for 2022/2023

35 The use of BNPL could be seen as problematic because it is less regulated, which means borrowers have fewer protections from being given unaffordable credit and from unsustainable repeat use. Further, most of the profits from BNPL users rely on them defaulting.[26]

36 However, as from 2 September 2024, the CCCFA will apply to BNPL, so that consumers using this form of credit will receive many of the same protections as borrowers in other consumer credit contracts. Obligations will nevertheless be proportionate, having regard to the nature of BNPL and the lack of interest and credit fees.

37 The obligations BNPL lenders will need to comply with include:

a. to obtain a mandatory comprehensive credit report when customers sign up or increase their credit limit
b. to develop a credit policy that explains how credit report information is used when assessing whether or not to provide credit to a borrower
c. to be part of an external dispute resolution scheme and provide details of the scheme if borrowers make a complaint or hardship application
d. to comply with disclosure obligations
e. for their directors and senior managers to comply with due diligence duties and to be certified by the Commission to be fit and proper persons for their respective positions.

Financial assistance from the government

38 There has been an increase in debt to government in the same period during which high-cost lending has disappeared. Hardship assistance is available from MSD for people who need support to meet immediate and essential needs and who meet the eligibility criteria.

39 In the year to May 2020, prior to the introduction of the high-cost credit provisions, MSD approved 2.46 million hardship grants, with an average of $282 per grant. This compares with 2.54 million hardship grants given in the year to May 2021, with an average of $341 per grant. The main reasons for granting these loans remained identical (food, emergency payments and housing).

[25] As above footnote 22.
[26] Merchants are generally charged fees to make use of buy now pay later services, but consumers are not typically charged upfront fees to sign up.

40 Of all unique debts owed to different creditor types, FinCap financial mentors report that 21.7 per cent were owed to MSD in 2022. This is an increase of 4.3 per cent from 2021.[27] Over the same period, the total sum of debt owed to MSD increased by 14.6 per cent.[28]

41 It is unclear whether the increase in MSD grants is linked to the removal of the high-cost lending. It is likely that this increase is attributable to other factors such as the wider economic climate, rather than the elimination of the high-cost credit sector.

Unofficial lending

42 One possible outcome of reduced access to credit is that borrowers may turn to illegal lending. However, financial mentors have told us that they are not aware of significant illegal lending activity. Overseas experience suggests an increase in illegal lending has not been a significant problem following the introduction of measures restricting access to high-cost consumer credit.

43 The Commission investigates reports of uncertified/unregistered lenders, informed by complaints and proactive monitoring (including regular engagement with financial mentors).

44 Another type of unofficial lending is borrowing from family or friends. This type of lending is limited because family or friends may also have limited financial capacity, and evidence suggests such borrowing is not always a positive experience (eg can carry feelings of shame or stigma and negatively affect relationships). Of FinCap mentoring clients, this type of unofficial lending made up only 3.2 per cent of debts in 2022.[29]

Forgoing the good/service/payment etc for which the loan was wanted

45 It is difficult to obtain evidence as to whether would-be borrowers are simply going without the good/service/payment for which a high-cost loan might have been taken out, rather than turning to other funding sources.

46 A 2020 Colmar Brunton survey conducted for MBIE[30] found the following results among those declined credit for a "short-term loan":

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[27] As above footnote 22.
[28] As above footnote 22.
[29] As above footnote 22.
[30] This research surveyed 1,000 consumers. Colmar Brunton (July 2020). *Credit baseline research*.

Table 4 – Those declined credit for a short-term (<12 months) loan in 2019

WAS BEING DECLINED GOOD OR BAD	ACTIONS TAKEN AFTER DECLINED CREDIT	ABLE TO PAY FOR WHAT THEY NEEDED
30% said it was a good thing	80% reduced spending on important living expenses	43% were still trying to pay for what they needed
22% said it was a bad thing	52% asked family member or friend	40% were able to pay for what they needed
45% said it was neither a good nor bad thing	35% applied for same type of credit with another lender	17% gave up trying to pay for what they needed
3% said they do not know	34% applied for a different type of credit	
	24% used an existing credit line.	

47 As this survey data does not analyse high-cost loans specifically (roughly half of the "short-term loans" in the survey were provided by banks), we cannot say whether simply "going without" is positive or negative for would-be high-cost loan borrowers.[31] It is difficult to survey would-be borrowers about being declined for high-cost consumer credit, given this type of credit is no longer in the market.

48 It also depends on the loan purpose. If a would-be borrower is going without essential expenses, then it might be negative for that would-be borrower and their family, even if it results in avoiding further debt.

[31] In the UK, the Financial Conduct Authority surveyed current and former high-cost borrowers and found that 63 per cent of those declined credit after the introduction of cost of credit and rate caps believed it was for the best, while 28 per cent said that it would have been better if their application had been approved. Financial Conduct Authority (July 2017). *High-cost credit: including review of the high-cost short-term credit price cap, Feedback Statement 17-02*, https://www.fca.org.uk/publication/feedback/fs17-02.pdf.