

Submission by



to the

Ministry of Business, Innovation & Employment (MBIE)

on the

**Review of Consumer Credit Regulation Discussion
Paper**

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REVIEW OF CONSUMER CREDIT REGULATION – SUBMISSION BY BUSINESSNZ¹

1.0 INTRODUCTION

- 1.1 BusinessNZ welcomes the opportunity to make a submission to the Ministry of Business, Innovation & Employment (MBIE) on the 'Review of Consumer Credit Regulation' (referred to as 'the Discussion Paper').
- 1.2 We have previously submitted on the issue of interest rate caps, going back as far as 2012 when it was first examined. Our view both then and now is that the success or otherwise of consultation is determined solely by a willingness to change legislative elements in order to minimise unintended outcomes and/or costs.

RECOMMENDATIONS

- 1.3 It is recommended that:
- a) The proposed changes aim to minimise the extent to which legitimate lenders are adversely affected (p.3);**
 - b) Interest rate caps are not introduced (p.4);**
 - c) Despite BusinessNZ's support for the status quo option, if change is to occur, option A is the best alternative (p.5);**
 - d) BusinessNZ's views on irresponsible lending options in table 2 are noted (p.7);**
 - e) That options A and B for continued predatory behaviour by mobile traders do not proceed (p.8);**
 - f) BusinessNZ's views on unreasonable fees options in table 3 are noted (p.9); and**
 - g) Small business loans, investment loans and family trusts remain outside the protection of the CCCFA (p.9).**

2.0 BACKGROUND

- 2.1 Overall, BusinessNZ is in favour of identifying where improvements in consumer credit regulations can be made. We believe that before its introduction, any new regulation should pass a high threshold test in terms of a proper policy process and the Paper highlights the fact that only a very small percentage of credit providers (typically referred to as 'loan sharks' and 'mobile traders') has caused financial hardship and spiralling debt for some consumer groups. As a consequence, often reputable lower tier credit providers have found themselves tarred with the same brush even though since the 2015 amendments, they have in almost all cases adhered to the changes made. And this despite many being proactive in helping their customers and ensuring checks and balances are in place to stop debt spiralling out of control.
- 2.2 It is important to note that as with anything in life, there is an optimal amount of risk. There will be instances where despite the best intentions of both the lender and

¹ Background information on BusinessNZ is attached as Appendix One.

borrower, some credit contracts will fall over. No matter what policies are implemented, risk cannot be fully eliminated.

- 2.3 The aim should be to strike the right balance between legislation that will nullify the actions of loan sharks while ensuring against additional compliance costs for legitimate and scrupulous lenders. But in reality this might be tricky to achieve. There is every possibility unscrupulous lenders will in some way change their operations to minimise new consumer protections. How they react could range from selectively ignoring aspects of the legislation (which seems to happen in a number of cases), through to running their business in an illegal manner. Therefore, the only long-term solution is to ensure customers have financial knowledge sufficient to make the right choices and to understand fully the implications of what they are signing on for.
- 2.4 As with the 2012 consultation, the proposed legislation is pinpointed at a small sub-set of lenders but we are concerned that in reality it will catch a far wider group. BusinessNZ has no particular views on ways in which such spillover costs can be minimised, not being involved in the day-to-day activities of the varying lenders in the market. However, we do know that lenders directly involved in the sector will be submitting on the Discussion Paper. Therefore, we recommend the Minister ensure solutions to the perceived problem focus on minimising the extent to which legitimate lenders are adversely affected.

Recommendation: That proposed changes aim to minimise the extent to which legitimate lenders are adversely affected.

3.0 PROGRESSION UP THE REGULATORY PYRAMID

- 3.1 In general, we believe the Discussion Paper does a good job of identifying the pros and cons of each option presented and we congratulate officials on ensuring these key aspects are discussed. We also welcome the fact that a number of options are attached to each issue, indicating more than one pathway to policy development. This is exactly the right approach for a Paper that is seeking feedback.
- 3.2 It goes without saying that before opting for a regulatory approach, the nature of the problem should first be fully understood - who is affected by it, the cost of taking action and who will bear that cost. Regulatory intervention is costly and should generally be a last resort engaged in only when all other cost-effective approaches have been exhausted. To justify government intervention, there must be a clear case of market failure and the market failure problem must be significant.
- 3.3 It is imperative to address the fundamental question "*is there a problem?*" before considering any change to regulatory practices. We would go further, asking policymakers to consider some related questions, including, but not limited to:
 - Is there a problem *in New Zealand* with the current law (i.e. is there a significant "market failure" issue which needs to be addressed)?
 - If there is a problem, is the problem significant?
 - What are the costs and benefits (including unintended costs) of any of the proposed changes outlined in the document?
 - Are there options for improving outcomes which do not impose significant costs (e.g. by educating market participants)?

- 3.4 In considering these questions, BusinessNZ strongly adheres to the idea of *travelling up the regulatory pyramid*, that is, considering non-regulatory options first, moving “up the pyramid” to generic light-handed options and introducing more stringent measures only if clearly warranted.
- 3.5 There will be two inevitable consequences from not taking the regulatory pyramid approach. First, putting aside the question of whether changes are required in the first place, no regulatory change should impose more cost on already compliant and best practice businesses in the sector but make little or no difference elsewhere. That would represent a fundamental policy failure given there would be little reward for significant harm.
- 3.6 Second, BusinessNZ is concerned any change could create a “waterbed effect”, with regulatory solutions in one area producing a different problem elsewhere. This effect is alluded to throughout the Paper, for example, where it discusses whether tighter rules for one set of fees would see loans restructured to circumvent the change.
- 3.7 Since the Paper has allocated time to identifying key aspects of policy development, we want to ensure potential changes are looked at in their entirety, taking into account where each sits on the regulatory pyramid model.

4.0 EVENTS UP TO THE DISCUSSION PAPER

- 4.1 The Discussion Paper’s inclusion of interest rate cap options is obviously a talking point for many looking to see regulatory changes in the credit contracts and consumer finance areas. The possible introduction of interest rate caps has been in the public arena for some time. For instance, a 2010 private member’s Bill from the then Labour MP Carol Beaumont, *Credit Reforms (Responsible Lending) Bill*, sought, amongst other reforms, to prescribe maximum annual percentage rates of interest payable in respect of consumer credit contracts. The Bill, a blunt tool, was defeated as its unintended side effects would have likely been substantial. It would have been better to consider potential changes in this area in an overall review of credit contracts and consumer finance, ensuring the various aspects are better understood from a policy perspective.
- 4.2 In the lead up to draft legislation, BusinessNZ attended the Financial Summit in August 2011 where it opted for the Affordable Credit/Social & Community Lending Breakout group. In addition to discussions on affordable credit and social lending, there was a strong focus on the issue of interest rate caps. At the time, to assist in discussion on this issue, officials provided a summary sheet highlighting the main arguments for and against introducing a cap and setting out an excellent summary of the views both for and against interest rate caps. Many of the summary sheet’s arguments against interest rate caps were reiterated by those attending the breakout group who were involved in the industry and could see first-hand the ramifications of introducing such a policy.
- 4.3 Therefore, given officials’ already extensive analysis as well as the private sector’s clear feedback to the summit - still relevant today - BusinessNZ opposes the introduction of interest rate caps.

Recommendation: That interest rate caps are not introduced.

5.0 PARTICULARS OF THE DISCUSSION PAPER

5.1 Without prejudice to BusinessNZ's primary recommendation, we would like to address a number of issues outlined in the Paper relating to the introduction of consumer credit regulation.

Issue 1: Excessive Cost of Some Consumer Credit Agreements

5.2 The Paper provides four options in respect to the introduction of interest rate caps. BusinessNZ's order of preference is outlined in table 1 below.

Table 1: Order of preference regarding capping interest and fees

Option	Order of Preference
Status Quo	1
Option A: Limit the accumulation of interest and fees	2
Option B: Reduce the highest interest rates and limit accumulation of interest and fees	3
Option C: Set a low interest rate cap to eliminate high cost lendings	Do not support

5.3 We believe the best long-term solution is to remain with the status quo and instead focus resources on financial education, to ensure New Zealanders know not to enter into such arrangements in the first place. However, of the change options provided, limiting the accumulation of interest and fees does not directly involve a cap on the interest rates that can be charged. Rather it creates a ceiling whereby borrowers would never pay back more than twice the original loan principal. By contrast, the remaining two options both cap interest rates, the last option providing a strict interest rate and fees cap of between 30% and 50% per annum.

5.4 The summary table on page 15 of the Paper succinctly shows how the options would work in practice, including identified best and worst case outcomes. In particular, likely end outcomes when high-cost loans are prohibited highlight how the worst case scenario could play out, namely, a borrower using an illegal lender and ending up borrowing more for a longer time period. Even under the best case scenario, there is the potential for friends and family to be caught up in a debt problem by becoming lenders. This in itself could have broader unintended consequences if the borrower is unable or neglects to pay back a loan, dragging others into the borrower's problem.

5.5 While option B can be seen as a half-way house between options A and C, the amount one person can charge another should not be capped. As discussed above, interest rate capping is a blunt tool for policy makers. Option A is a better step along the regulatory pyramid if a change is considered necessary.

Recommendation: Despite BusinessNZ's support for the status quo option, if change is to occur, option A is viewed as the best alternative.

Issue 2: Continued Irresponsible Lending and Other Non-Compliance Issues

5.6 Table 2 below outlines BusinessNZ's overall stance on the various options for dealing with irresponsible lending and other forms of non-compliance, also examined from a regulatory pyramid perspective. Immediately introducing all identified options would show little understanding of the need to ensure a stringent process was followed.

- 5.7 Of the options provided there are some we support, some we support in principle, and some we do not believe should proceed. Of those supported in principle, support is contingent on ensuring no unnecessary costs are placed on the main compliant providers in the market. Often it is those who comply with current regulations/principles who bear the additional brunt of further changes through increased compliance obligations.

Table 2: BusinessNZ stance regarding irresponsible lending options

Registration Options	BusinessNZ Stance
Expanded powers to deregister lenders and ban directors from the industry	Support in principle
Fit and proper person registration test	Support in principle
Comprehensive creditor licensing system	Do not support
Enforcement Options	
Pecuniary penalties, statutory damages and injunction orders for breaches	Support in principle
Directors' duties	Do not support
Substantiation obligation for lenders	Support in principle
Increase industry levy to fund advocacy, monitoring and enforcement	Do not support
Require creditors to work with consumers' advocates if asked	Support
Responsibility Options	
Introduce more prescriptive requirements for conducting affordability assessments	Do not support
Introduce more prescriptive requirements for advertising	Do not support
Require disclosure to be in the same language as advertising	Support

Registration Options

- 5.8 Of the registration options provided, there is merit in investigating a further expansion of the power to deregister lenders and ban directors, accompanied by a fit and proper person licensing system. The most extreme option is the proposal to establish a comprehensive creditor licensing system. As the table on page 25 notes, there are two significant costs with this option, namely relatively high costs on affected lenders (which could be passed on to borrowers) and the chance of such lending going underground, creating a whole new set of issues and risks.

Enforcement Options

- 5.9 With enforcement options, the requirement for creditors to work with consumers' advocates could be a useful first step forward. Pecuniary penalties for breaches and substantiation obligations on lenders can be seen as reasonable as compliant lenders most probably already record this information.

- 5.10 BusinessNZ does not support director's duties nor an increased industry levy to fund advocacy etc. Other legislation has recently sought to increase the responsibilities/punishments on directors, particularly via the introduction of criminal sanctions. Continually trying to punish directors is likely to have swift and negative consequences both in respect to established and prospective directors. A substantial increase in risk from not following through with duties imposed could create a shortage of quality directors. But whether it would have any effect on directors involved in deceptive arrangements is at best debatable.
- 5.11 At this stage there is no need for an industry levy to fund advocacy, monitoring and enforcement. Just because industry levies are collected in other areas does not mean further levies should automatically be collected. Each situation needs to be evaluated on its merits. If the Commerce Commission believes monitoring and enforcement would be useful for the long term aim of achieving a reasonable standard of living for individuals and families, it should first establish whether existing taxpayer funds should be reallocated for funding purposes. There will always be trade-offs in respect to taxpayer funding allocation. Examining how reprioritising existing funding might help would be a first step.

Responsibility Options

- 5.12 Of table 2's responsibility options, the option requiring disclosure to be in the same language as advertising is supported. Communications to borrowers should be in the language with which they are most comfortable. Changing languages from advertising to disclosure would likely create significant doubt and confusion for the borrower and represent a poor process on the lender's part.
- 5.13 Any moves to introduce more prescriptive requirements for conducting affordability assessments and advertising need to be treated with caution. BusinessNZ agrees with the point outlined on page 26 that some currently compliant lenders would incur additional compliance costs as existing practices would be out of step with more heavy-handed prescriptive requirements. On the flip side, the Paper notes there would be only a small reduction in irresponsible lending.

Recommendation: That BusinessNZ's views regarding irresponsible lending options in table 2 are noted.

Issue 3: Continued predatory behaviour by mobile traders

- 5.14 BusinessNZ sympathises with society's most vulnerable consumers caught by the effects of the irresponsible and predatory behaviour of certain mobile traders. However, we believe the Paper's options for addressing credit sales falling outside the CCFA may not be the best way to proceed.
- 5.15 Option A would include credit contracts that charge default fees in the definition of consumer credit contract. This significant scope extension could lead to various contracts being inappropriately captured, while at the same time lead lenders, at whom the changes are targeted, would simply stop charging default fees. In short, the wider implications of this option could be too great to warrant its introduction.
- 5.16 Option B involves prohibiting the price of goods and services sold on credit from exceeding the cash price. Again, the intent can be appreciated but how the proposal fits within New Zealand's current economic model – which is centred on a market economy – is open to question. A good or service is worth only the price someone is willing to pay. Regulatory steps prohibiting a cash price above a certain "fair value" would, at the very least, set a dangerous precedent when it comes to permissible charges.

- 5.17 According to paragraph 93, cash price would be defined either as the lowest price for which the goods or services could be purchased from the supplier, or their fair market value at the time the contract was made. Unlike the Paper's other proposals, which are more clearly defined as to actions to take or specific requirements met, there is a level of subjectivity with this option which would make monitoring difficult. The option would also create a grey area where it would be unclear whether or not lender actions fell within the new regulations. To illustrate, using the iPhone 8 example on page 29, would a price of \$1,299 compared with a price from Apple of \$1,249 constitute a clear and automatic violation of the new regulations? If so, would \$1,260, which is within 1% of the Apple price? Further, given a whole host of reasons for real time price movements, trying to determine the correct market price could, despite best intentions, create significant costs and uncertainty for business, not to mention the very real threat of prosecution for relatively minor differences.
- 5.18 Looking at the costs and benefits of page 29's two options, it appears likely benefits would not significantly outweigh the large costs (both intended and unintended) imposed. Therefore, options A and B are not supported.

Recommendation: That options A and B for continued predatory behaviour by mobile traders do not proceed.

Issue 4: Unreasonable fees

- 5.19 Issue 4 examines unreasonable fees and table 3 below summarises BusinessNZ's views on the paper's three options.

Table 3: BusinessNZ stance regarding irresponsible lending options

Option	BusinessNZ Stance
Option A: Require lenders to substantiate reasonableness of fees	Support in principle
Option B: Impose specific fee caps in regulation	Do not support
Option C: Disclosure and advertising based on an annual percentage rate that combines interest and fees	Do not support

- 5.20 BusinessNZ does not support Option B imposing specific regulatory fee caps. As with specific caps on interest rates discussed above, this is a very blunt and crass tool for policymakers to use. While paragraph 102 of the Paper notes that fee caps '*could vary according to the size of the loan, whether it is secured or unsecured and whether the security interest is over real or personal property*', any perceived flexibility would be undermined by an arbitrary set of industry rules that failed to take into account the critical market drivers of risk and return.
- 5.21 In addition, the summary table on page 33 rightly points out that even with specific fee caps, lender outgoings could be recouped by increasing interest rates, a logical reaction when assessing customer risk. Of course the ability to do this would be severely hampered if interest rate caps were also introduced, a development that could see cross subsidisation between borrowers playing an even stronger hand.
- 5.22 In principle, relative to the other two, option A, requiring lenders to substantiate the reasonableness of their fees, is the most straightforward and sits most comfortably with current fee regulation. With the added benefit of aiding enforcement, we believe this option provides the most practical way of implementing change.

5.23 Option C would not create the same unintended consequences and upheaval as option B, but as page 33 indicates, there would be significant transition costs for lenders, as well as this option's challenging aspect when certain loan structures are examined (i.e. revolving credit).

Recommendation: That BusinessNZ's views in table 3 regarding unreasonable fees options are noted.

Issue 5: Small business loans, investment loans and family trusts

5.24 On page 41, the Paper points out that small business loans, investment loans and family trusts are excluded from the protections of the CCCFA. This is fundamentally the right principle and future changes are not supported.

5.25 As the Paper notes, there is an inherent expectation that businesses, investors and trustees have a far greater level of financial literacy than most consumers. Therefore, any loans should involve a level of due diligence that should reveal if there are likely risks. There will always be isolated instances of certain entities being harmed by borrowing to invest but this should not be justification for significant changes to the regulatory landscape. Consideration should be given to examining this issue only when and if a problem is widespread and ongoing.

5.26 BusinessNZ is not aware that the exclusion of business and investment loans and family trusts from CCCFA protection is a significant issue for its membership and would be concerned about the possible unintended consequences of including such entities in the CCCFA. Undoubtedly, higher rates of borrowing would be one obvious outcome.

Recommendation: That small business loans, investment loans and family trusts remain outside the protection of the CCCFA.

Appendix One - Background information on BusinessNZ



BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups [EMA](#), [Business Central](#), [Canterbury Employers' Chamber of Commerce](#), and [Employers Otago Southland](#)
- [Major Companies Group](#) of New Zealand's largest businesses
- [Gold Group](#) of medium sized businesses
- [Affiliated Industries Group](#) of national industry associations
- [ExportNZ](#) representing New Zealand exporting enterprises
- [ManufacturingNZ](#) representing New Zealand manufacturing enterprises
- [Sustainable Business Council](#) of enterprises leading sustainable business practice
- [BusinessNZ Energy Council](#) of enterprises leading sustainable energy production and use
- [Buy NZ Made](#) representing producers, retailers and consumers of New Zealand-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation ([ILO](#)), the International Organisation of Employers ([IOE](#)) and the Business and Industry Advisory Council ([BIAC](#)) to the Organisation for Economic Cooperation and Development ([OECD](#)).