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Minister	Hon Kris Faafoi	**Portfolio**	Commerce and Consumer Affairs
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List of documents that have been proactively released		
Date	**Title**	**Author**
28 August 2019	Review of Consumer Credit Regulation – further policy recommendations	Office of Hon Kris Faafoi
28 August 2019	DEV Minute: Review of Consumer Credit Regulation: Further Policy Proposals	Cabinet Office
28 August 2019	Impact Summary: Review of Consumer Credit Regulation – further policy recommendations	MBIE

Information redacted **YES / ~~NO~~**

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In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

REVIEW OF CONSUMER CREDIT REGULATION – FURTHER POLICY RECOMMENDATIONS

Proposal

1. This paper seeks Cabinet's agreement to include three additional items in the Credit Contracts Legislation Amendment Bill (**the Bill**) through a Supplementary Order Paper, if needed, at Committee of the whole House stage.

Executive Summary

2. The Credit Contracts and Consumer Finance Act 2003 (**the Act**) regulates the provision of credit in New Zealand. The Bill introduces a package of changes designed to better protect vulnerable consumers from irresponsible and predatory lending. It strengthens requirements to lend responsibly, limits the accumulation of interest and fees on high-cost loans, and provides new remedies and penalties for lender non-compliance.

3. The Bill is currently before the Finance and Expenditure Committee (**the Committee**), and submitters have proposed a range of significant items for inclusion in the Bill.

4. I consider that three of these changes should be included in the Bill. These will help to achieve the Bill's aims of reducing irresponsible lending and problem debt:

   4.1. add an interest rate cap of 0.8 percent per day, in addition to the existing 100 percent total limit on interest and fees;

   4.2. apply a wider range of requirements from the Act to mobile traders, particularly responsible lending;

   4.3. enable a requirement on lenders to provide contact details for financial support services when borrowers have overdue payments.

Background

5. The Bill is the result of a review that identified ongoing issues in the credit market and significant harm to vulnerable consumers from problem debt. The issues identified included the excessive cost of some consumer credit agreements; continued irresponsible lending and other non-compliance, including by mobile traders; unreasonable fees; and irresponsible debt collection practices.

6. The Bill addresses these issues by strengthening requirements to lend responsibly, especially in relation to requirements regarding how affordability and suitability tests

should be conducted, limiting the accumulation of interest and fees on high-cost loans, and providing new remedies and penalties for non-compliance.

7. The Bill is currently before the Committee. A total of 434 organisations or individuals made written submissions on the Bill, and oral submissions have now been completed. The Committee is required to report to the House of Representatives by 30 October.

Constitute contempt of Court/House of Representatives

Introduce an interest rate cap to reduce the highest interest rates and limit accumulation of interest and fees

9. Some lenders offer small loans over short timeframes. These credit products are referred to as ‘high cost’ on the basis of their very high annualised interest rates (up to 800% per annum).[1] Problems arising from the use of high-cost loans include:

   9.1. financial harm from frequent use of high-cost loans

   9.2. debt spirals, as high-cost loans are more likely to result in unmanageable debt which accrues indefinitely, and subsequent financial hardship

   9.3. that a disproportionate number of concerns about irresponsible lending relate to high-cost lenders.

10. It is estimated that at least 150,000 consumers use high-cost lenders each year.

11. The Bill currently proposes to limit the total cost of borrowing (including default interest and fees) to 100 percent of the original loan principal over the lifetime of the loan. This means that the borrower taking out a $500 loan would repay no more than $1,000. This proposal would only apply to high-cost lenders, and its aim is to prevent borrowers taking on unmanageable debt and financial hardship from accumulating large debts from a small loan.

12. While this proposal was broadly supported in submissions to the Committee, 388 submitters, including all budget services, overwhelmingly considered that the Bill should include an interest rate cap to address harms caused by high cost lending.[2]

Debt is a public health issue

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[1] Note that Cabinet agreed that a ‘high-cost loan’ will be based on the relevant Responsible Lending Code definition: ‘where the annualised interest rate is 50 percent or more’ [CAB-18-MIN-0466].

[2] Submitters included FinCap, Citizens Advice Bureau New Zealand, Community Law Centres o Aotearoa and all budget service submissions. The only submitters to oppose an interest rate cap were high-cost lenders Cash Converters and Save My Bacon.

13. The Auckland Regional Public Health Service submitted to MBIE in favour of interest rate caps, and the Royal Australasian College of Physicians submitted to the Committee in favour of stronger regulation than the Bill currently provides. Research shows that in addition to financial impacts, debt has serious detrimental impacts on health and wellbeing:

13.1. debt and financial problems are linked to the development and aggravation of anxiety and depression[3]

13.2. people in problem debt are twice as likely to think about suicide, even after controlling for other socioeconomic and demographic factors[4]

13.3. financial difficulty significantly reduces recovery rates for common mental health conditions[5]

13.4. financial difficulties drive additional demand for healthcare services from general practitioners and hospitals[6]

13.5. financial difficulties result in worse relationships with family and friends[7]

13.6. When unable to keep up with loan repayments, Māori whānau have described 'going to ground', feeling overwhelmed, and too much shame to approach lenders to discuss relief options[8]

13.7. Pacific families report that high levels of household debt is in many cases intergenerational, which significantly impacting their wellbeing. Having sufficient income to fulfil cultural contributions is very important, and not being able to do so can be a source of shame.[9]

14. In light of submissions from the wide range of organisations that see first-hand the impacts of high-cost lending on consumers, a further consumer protection which

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[3] Dackehag M., Ellegård LM., Gerdtham UG. & Nilsson T. (2019). Debt and mental health: new insights about the relationship and the importance of the measure of mental health, European Journal of Public Health, Volume 29, Issue 3, 488–493.

[4] Meltzer, H., Bebbington, P., Brugha, T., Jenkins, R., McManus, S., & Dennis, M. (2011). Personal debt and suicidal ideation. Psychological Medicine, 41(4), 771–778, cited in Katie Evans. (2018). Treating financial difficulty – the missing link in mental health care? Journal of Mental Health, 27:6, 487-489.

[5] Skapinakis, P., Weich, S., Lewis, G., Singleton, N., & Araya, R. (2006). Socio-economic position and common mental disorders: Longitudinal study in the general population in the UK. British Journal of Psychiatry, 189(02), 109–117; cited in Evans (2018) footnote 6 above.

[6] StepChange. (2015). Statistics Yearbook: Personal Debt 2014. Retrieved on 16 August 2019 from: https://www.stepchange.org/Portals/0/documents/media/reports/statisticsyearbooks/StepChangeDebtCharityStatisticsYearbook2014.pdf

[7] StepChange (2015). Footnote 6 above.

[8] Te Puni Kokiri (2019). Microfinance Research Summary. Retrieved on 21 August 2019 from: https://www.tpk.govt.nz/en/a-matou-mohiotanga/business-and-economics/microfinance-research-summary

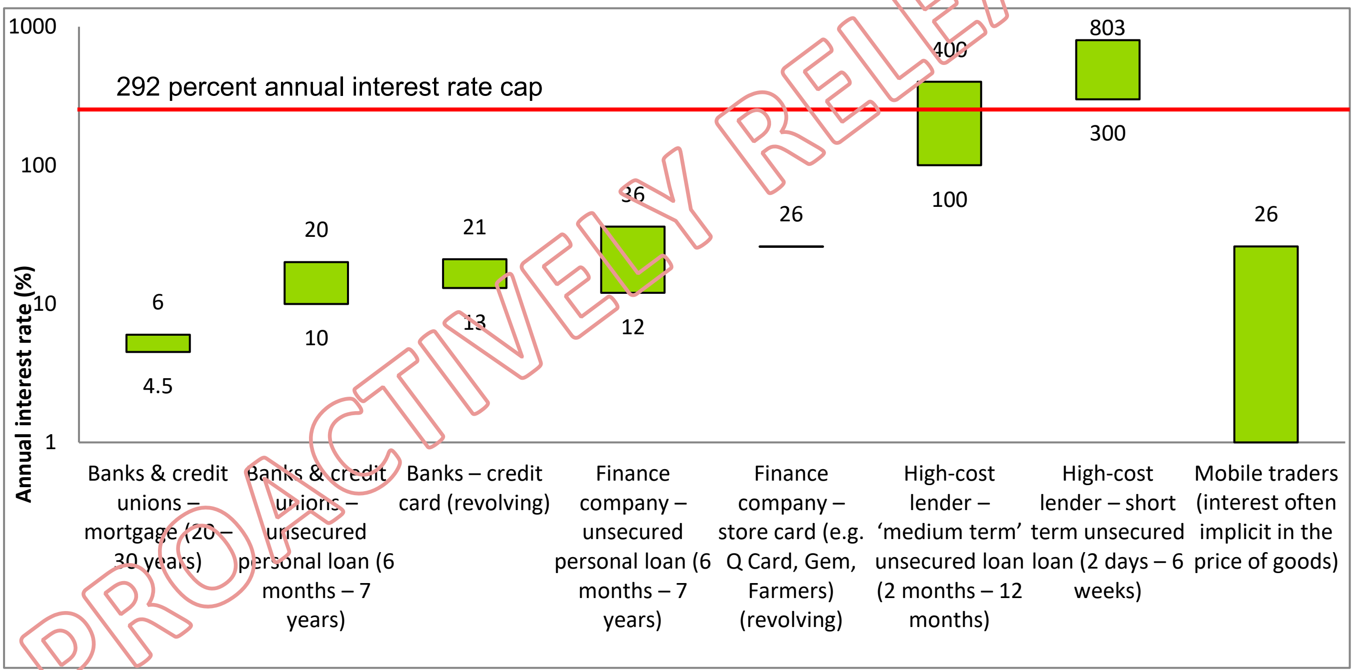
[9] Welfare Expert Advisory Group. (2019). Whakamana Tāngata: Restoring Dignity to Social Security in New Zealand. Retrieved on 21 August 2019 from: https://www.tpk.govt.nz/en/a-matou-mohiotanga/business-and-economics/microfinance-research-summary

reduces the highest interest rates, and reduces irresponsible lending is appropriate and would have significant overall benefits.

Interest rate cap proposal

15. An interest rate cap directly limits the level of interest and fees charged to borrowers. It will strengthen the current proposal in the Bill that limits the total cost of borrowing. I propose an interest rate cap of 0.8 percent per day, or 292 percent per annum. This is a significant reduction on the interest rates imposed by high-cost lenders, shown in the graph below. Officials are currently designing the finer details of the cap. I seek delegated authority to complete this work, consistent with Cabinet's decisions in this paper.

Figure 1: Graph showing the impact of an interest rate cap on the annual level of interest and fees charged to borrowers



16. This proposal is similar to that used in the United Kingdom since 2015. Eight states in the United States of America cap interest and fees at a roughly similar level.[10] Based on this overseas experience, I would expect the interest and fee rate cap to be largely complied with by lenders, and therefore borrowers using high-cost lending services would pay substantially less in interest and fees. This should contribute to lower rates of default and reduced hardship as a result of high-cost lending.

17. Some submitters proposed a low 50 percent cap on interest rates. I decided against this approach because it would effectively prohibit all high-cost lending. My view is that

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[10] Oregon, Rhode Island Indiana, Kansas, Michegan, Minnesota, Oklahoma and South Carolina all have annualised percentage rates (APR) of between 154 percent and 390 percent on a 14-day loan. Source: Stace V., & Finn J. (2019). Working Towards a Fairer Consumer Credit Market, A study of the issues in New Zealand's consumer credit market and proposals for reform – Interest rate caps. Wellington, Michael and Suzanne Borrin Foundation.

high-cost lending should still be an option for consumers who have a genuine financial need, and who can afford the repayments.

The potential impact on borrowers of the proposed interest rate cap

18. As well as generally reducing the amount of interest and fees paid by borrowers, an interest rate cap would help to address a number of problems with high-cost lending that contribute to financial hardship. It would limit the rate at which interest and fees accumulate on loans in default, making it easier for borrowers to get back on track with payments. It would also help to address concerns about uninformed borrowers entering into contracts with uncompetitive interest rates and fees. It would partly address issues of borrowers making frequent use of high-cost loans by reducing the amount of high-cost lending and pushing lenders to offer longer term, lower cost loans.

19. The financial lever of a cap on interest rates is also likely to reduce irresponsible lending because it will limit the profitability of high-cost lending and see lenders taking fewer risks on borrowers they are willing to lend to. As lenders close and tighten lending criteria, some consumers will no longer be granted high-cost loans and will instead need to find alternative solutions.

20. A rough estimate of the impact in New Zealand can be obtained by applying the United Kingdom experience.[11] If the impact is similar, the number of consumers accessing high-cost lending may fall from around 150,000 per year presently to around 90,000.

21. For those in financial difficulty, it is arguably far better to struggle to make ends meet in the short term, than to stave off immediate need with an unaffordable high-cost loan, and become indebted for a much greater sum.

22. The experience in the United Kingdom for those declined high-cost credit, based on three different studies, was that around a third of declined borrowers turned instead to family and friends. A further 13–34% went to other lenders, 17–24% managed or cut back, and 18–27% reported they had no other options. Based on the estimated number of users of high-cost credit in New Zealand, this group with no other options could be up to 14,000 people in size. Other avenues for assistance include:

    22.1. arranging deferred payment processes for bills, rent or services

    22.2. using hardship processes with other lenders

    22.3. selling personal possessions

    22.4. seeking in-kind support from community organisations

    22.5. seeking a hardship grant from the Ministry of Social Development (**MSD**).

23. Microfinance products, including those subsidised by the MSD are small scale and in the short term are unlikely to address the potential shortfall resulting from this proposal. However, a major bank is currently increasing funding to expand the availability of no- and low-interest loans. To provide lead time for this expansion, I propose that the

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[11] Following the introduction of an interest rate cap, the number of people obtaining high cost credit in the United Kingdom reduced from 2.2 million (over and 18-month period to 1.3 million.

commencement date for the interest rate cap be set at 1 June 2020 (rather than immediately after assent). I expect that the introduction of an interest rate cap will encourage the further expansion, and greater awareness of, charitable and non-profit alternatives.

24. Despite the positive developments on foot, the small scale of microfinance offerings presently available in New Zealand means there is potential for impact on the timing of hardship grant applications made to the MSD. However, the nature and scale of any impact is unclear. This is discussed further below and in the financial implications section.

Impacts for the Ministry of Social Development

25. Hardship assistance is available from MSD for people who need additional support to meet immediate and essential needs that cannot be met from their own resources. MSD currently pay around 150,000 hardship grants per month, with an average grant of around $300. The number of hardship grants has grown significantly over the previous few years.

26. Support through MSD can be either non-recoverable or recoverable, and is often targeted for specific needs, such as Food Grants.

27. An interest rate cap will reduce the burden of debt for families, and therefore likely reduce hardship in the medium to long term. Over time, this may result in fewer applications for hardship grants.

28. However MSD has also advised that there may be an initial increase in hardship grant applications due to some families no longer having access to high-cost lending.

29. This Government believes it is important that individuals and families get their full and correct entitlements from MSD in the first instance, and therefore want to ensure those not already accessing the financial assistance they need are able to do so.

30. Addressing the impact of debt is also an important aspect of the welfare overhaul, and these proposals will help to contribute to this work.

Transitional arrangements

31. Consistent with the current proposal in the Bill which caps the total cost of borrowing, this proposal would not apply to existing agreements unless they are varied with effect after commencement. This will ensure that existing agreements are not affected.

Require mobile traders to comply with responsible lending and other relevant requirements of the Act

32. The Bill provides a package of changes designed to help reduce problem debt and resulting consumer harms (such as financial hardship, and mental and physical health issues). Mobile traders are widely reported to contribute to problem debt, including where they do not conduct adequate affordability assessments prior to providing credit contracts. Numerous, widespread and ongoing instances of harm caused by mobile

traders have been reported to MBIE during the Review of Consumer Credit Regulation, and to the Committee in relation to the Bill.

33. Most mobile traders provide consumer credit contracts and are regulated by the Act. However, some mobile traders provide credit contracts that do not have interest or fees, and that do not take a security interest over goods. Instead these traders include the cost of borrowing in the inflated prices of goods. This means that they are not "consumer credit contracts" and therefore these mobile traders are not subject to responsible lending requirements in the Act. As a result, these mobile traders do not have to provide disclosure or check that credit products are affordable and suitable for the borrower.

34. The Bill currently requires that the directors and senior managers of mobile traders be registered on the Financial Services Provider Register and be members of a dispute resolution scheme (even those who do not currently qualify as 'creditors'), and imposes a fit and proper person test on directors and senior managers as a prerequisite to registration.

35. In addition, the Bill contains a "deeming" power under which regulations can be made to deem a product to be a consumer credit contract and subject to the requirements of the Act. The intention is to use the power where this is needed to protect the interests of consumers. In developing the Bill, my officials and I considered that unregulated mobile traders were potential candidates for a future use of this regulation-making power.

36. However, numerous submissions were made to the Committee requesting that mobile traders be brought within the scope of the Act. This is consistent with submissions MBIE received during their review of the Act in 2018. I now consider that there is merit in implementing this change sooner through the Bill, rather than leaving it to regulations.

37. I propose that amendments be made to the Bill to apply the Act to all credit contracts provided by mobile traders. This means that all mobile traders will have to comply with the responsible lending and disclosure obligations for all their credit products. This will help to address issues with irresponsible lending by mobile traders and ensure that mobile traders cannot avoid the protections in the Act.

38. I consider the costs of this change are likely to be low for the market as a whole, although they will be significant for the minority of mobile trader businesses whose contracts are not currently covered by the Act. Most mobile trader contracts are already covered by the Act, including the largest mobile trader, so this change is primarily an "anti-avoidance" measure.

Payment reminders to provide contact details for financial support services

39. As part of the package of reforms, the Bill currently requires debt collectors to disclose key information about the debt to the borrower before the commencement of debt collection action, to help avoid irresponsible debt collection. This key information will be prescribed by regulations, and will include providing the contact details for financial support services, such as financial mentoring or budgeting services.

40. In submissions to the Committee, most budgeting services and several other submitters supported this proposal, but considered that it did not do enough to help borrowers manage their debt. Submitters suggested that steps could be taken earlier in the debt repayment process to help borrowers, well before debt collectors become involved.

41. It is in the interest of both borrowers and lenders for borrowers to repay what they owe. Research has found that if a borrower was struggling to meet their credit repayments, it was helpful for them to meet with a financial mentor or budgeting advisor early.[12] Financial mentors will often negotiate with lenders to come up with fair and affordable repayment plans. Financial mentoring uses strengths-based approaches that build financial capability and support borrowers to reduce their problem debt and achieve their financial goals. Strengths-based support has been demonstrated to activate capability and potential, including for Māori and Pacific whānau.[13]

42. I propose that the Bill include a regulation making power to permit a requirement on lenders to provide the contact details of financial support services such as the Minister of Social Development funded *MoneyTalks* helpline when a borrower is in arrears (for example, at the same time as payment reminders). This would help to encourage borrowers to seek advice from trained financial mentors at the earliest possible opportunity, rather than waiting until they are in default, when the arrears are larger and there are fewer options to address the issue. Budgeting and financial mentoring services are also able to link these borrowers into other appropriate help options.

43. I am aware that currently a range of lenders are already working with financial mentoring services to implement active referrals for customers who are at risk of hardship or are struggling with repayments. I will be encouraging other lenders to follow this example. The intention of my proposal is to ensure that, if needed, we can make this a prescriptive requirement.

44. Some submitters considered that lenders should be required to refer or provide information to consumers during the loan application process. However, I consider that the more targeted approach outlined above will be more effective at reaching those borrowers who are struggling to meet their repayment obligations.

45. I note that work is underway under the Safer Credit and Financial Inclusion Strategy to enhance the *MoneyTalks* helpline to better refer borrowers to a variety of support as relevant. The intention is to move to dispute resolution schemes, no-and low-interest loan providers, and debt alleviation services.

Consultation

46. These proposals have been developed during select committee consideration of the Bill. The select committee process included public consultation on the contents of the

[12] Green S, Robertson N & Nana Dr G. (2019). The harm from high cost lending: the case for increased and improved regulation. Wellington: BERL. Page 12.

[13] Torrie R & Bailey R. (2017). Frameworks and approaches for building the financial capability of New Zealanders experiencing hardship: a high level literature review. Wellington: Ministry of Social Development. Page 63.

Bill as originally drafted. Submitters included consumers, consumer advocates, lenders, a debt management service, industry associations and budgeting services.

47. The Treasury, MSD, Department of Prime Minister and Cabinet Child Poverty Unit and Parliamentary Counsel Office have been consulted on these proposals. The Department of Prime Minister and Cabinet has been informed.

Constitute contempt of Court/House of Representatives

Constitute contempt of Court/House of Representatives

[redacted]

Financial Implications

Enforcement

51. I do not expect any financial implications for enforcement. Additional funding of $3.50 million per year for four years for the Commerce Commission's General Markets Consumer appropriation and $0.50 million per year for four years to the Commission's major litigation fund was secured under the Budget 2019 process to give effect to the proposals in the Bill.

Vote Social Development

52. There is a risk that introducing an interest rate cap will increase applications for the hardship grant scheme administered by MSD.

53. Confidential advice to Government [redacted]

54. An interest rate cap has the ability to both increase and decrease hardship application grants. On one hand, an interest rate cap could reduce applications for hardship grants by reducing the interest rate costs for New Zealanders who have unaffordable and ongoing high-cost loans. On the other hand, there may be a migration of applications away from high-cost loans towards hardship grants as high-cost lenders seek to de-risk their loan portfolios by declining to loan to the most vulnerable New Zealanders in response to the cap on interest rates.

Confidential advice to Government

55. [redacted]

56. [redacted]

57. [redacted]

Confidential advice to Government

58.

Legislative Implications

59. The Committee is due to report back to the House on 30 October. If these proposals are not recommended by the Committee and subsequently accepted by Parliament, I intend that the proposals in this paper will be implemented through a SOP at the Committee of the whole House stage.

60. I am aware that in other jurisdictions where the legislature has set a cap on interest rates and regulated mobile traders, businesses have specifically designed new consumer loan products to fall outside of these requirements. I seek Cabinet's agreement to work with Parliamentary Counsel Office to design appropriate anti-avoidance provisions if this is necessary.

Impact Analysis

61. The impact analysis requirements apply to the proposals in this paper relating to mobile traders and payment reminders. An impact summary (RIS) for these proposals has been prepared and is attached at Annex 1.

62. A Regulatory Impact Analysis was carried out in the Review of Consumer Credit Regulation 2018 to inform the original proposals which went into the Bill. The relevant sections on interest rate caps are found in sections A2 – A5 and are attached at Annex 2. It received a meets from MBIE's Regulatory Impact Analysis Review Panel in 2018.

Quality of the impact analysis

63. MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached RIS prepared by MBIE. The Panel considers that the information and analysis summarised in the RIS meets the statutory criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Human Rights

64. There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Gender Implications and Disability Implications

65. The consumer protections proposed in this paper were developed with a focus on vulnerable consumers generally. However, people in hardship are disproportionately women. Women are more likely than men to lead a sole-parent family, which is one of the high-risk factors associated with both poverty and vulnerability as a consumer of credit. Similarly, people with disabilities are disproportionately in hardship, and may be particularly vulnerable if the disability relates to impaired decision-making. On this basis, a higher proportion of the people affected by these proposals are likely to be women, or people with disabilities.

Proactive Release

66. This paper will be proactively released and published on MBIE's website with any appropriate redactions under the Official Information Act.

Recommendations

The Minister for Commerce and Consumer Affairs recommends that the Committee:

1. **note** that on 9 April 2019 the Credit Contracts Legislation Amendment Bill (**the Bill**) was introduced to Parliament. It is the result of a review that identified ongoing issues in the credit market and significant harm to vulnerable consumers from problem debt;

2. **note** that the Bill addresses these issues by strengthening requirements to lend responsibly, especially in relation to requirements regarding how affordability and suitability tests should be conducted, limiting the accumulation of interest and fees on high-cost loans, and providing new remedies and penalties for non-compliance;

3. **note** that Cabinet has agreed to cap accumulated interest and fees of a high-cost loan, and any loan that repays or replaces it, to 100 percent of the original loan principal [CAB-18-MIN-0466];

4. **agree** to include a direct limit on the interest rate and fees (calculated together) of 0.8 percent per day on a high-cost loan, in addition to recommendation 3;

5. **agree** to review the interest rate cap three years after it has been in force;

6. **agree** that the interest rate cap will come into force on 1 June 2020;

7. **agree** to amend the Credit Contracts and Consumer Finance Act 2003 (**the Act**) to ensure all credit contracts entered into between mobile traders and borrowers have the same protections as consumer credit contracts for the purposes of the Act;

8. **agree** to a new regulation-making power in the Act to enable a requirement to be imposed in regulations on lenders to provide contact details of financial support

services to borrowers who are in arrears (for example at the same time as overdue payment reminders);

Confidential advice to Government

Legislative implications

11. **agree** to give effect to the above proposals through a Supplementary Order Paper, if needed, to the Bill, Confidential advice to Government

12. **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs;

13. **authorise** the Minister of Commerce and Consumer Affairs to design the interest rate cap to give effect to Cabinet's decisions in this paper;

14. **authorise** the Minister of Commerce and Consumer Affairs to make minor additional policy decisions and technical changes, consistent with the policy intent of this paper, on issues that arise in drafting of the Supplementary Order Paper;

15. **authorise** the Minister of Commerce and Consumer Affairs to work with Parliamentary Counsel Office to design anti-avoidance provisions, if required, so that future loan products cannot be designed to avoid Cabinet's decisions in this paper;

Constitute contempt of Court/House of Representatives

17. **note** that these policy changes are in line with the broader policy direction of protecting consumers from predatory and irresponsible lending.

Communication

18. **note** that this paper will be published on the Ministry of Business, Innovation and Employment's website.

Authorised for lodgement

Hon Kris Faafoi

Minister for Commerce and Consumer Affairs

Annex 1: Regulatory Impact Summary: Review of Consumer Credit Regulation – further policy recommendations

Annex 2: Regulatory Impact Statement: Review of Consumer Credit Regulation