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Submission on the Credit Contracts Legislation Amendment Bill
(June 2019)

To the **Finance and Expenditure Committee**
Select Committee Office
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We are grateful for the opportunity to submit on the Credit Contracts Legislation Amendment Bill*.*

We do not wish to make an oral submission to the Committee.

Introducing our organisation

Child Poverty Action Group (CPAG) is an independent charity that strives to achieve the elimination of child poverty in Aotearoa New Zealand. We work to provide evidence about the causes and effects of poverty on children and their families, and to inform the public, policymakers, media and politicians of the changes to policy needed to reduce child poverty. CPAG believes that New Zealand's high rate of child poverty is due to policy neglect and a flawed ideological emphasis on economic incentives. Through research, CPAG highlights the position of tens of thousands of New Zealand children, and promotes public policies that address the underlying causes of the poverty they live in. Our vision is for an Aotearoa where all children can flourish, free from poverty.

CPAG is based in Auckland, with regional groups located in Whangarei, Wellington, Christchurch, Dunedin and Nelson. CPAG is, with the Council for Christian Social Services and Federation of Family Budgeting Services (now FinCap) a founding member of Ngā Tangata Microfinance, a provider of small no fees no interest loans to low-income families since 2011.

Summary of this submission

The primary purpose of the Credit Contracts and Consumer Finance Act 2003 is "to protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land".

While we support the changes proposed in the Bill which increase the protections for consumers from predatory lending in a range of ways, we are concerned that this Bill, as currently drafted, does not adequately address the harm caused to consumers by predatory and irresponsible lending, and high cost loans. We are particularly concerned about the absence of an interest rate cap in this Bill.

We are recommending that the Government instates an interest rate cap, combined with the limit on the cost of borrowing already in the Bill. This would mean lower weekly repayments, making more funds available to support children/tamariki, and pay for essentials.

We also make a range of other proposals to strengthen the legislation. They include:

- Equivalent protection for loan guarantors as for borrowers;
- A ban on retail truck shops;
- More effective enforcement;
- Stronger regulation of debt collection; and
- A ban on the use of direct debit payment authorities by high cost lenders.

We appreciate the Commerce Commission making available their submission on the MBIE Discussion Document: Consumer Credit Regulation, 1 August 2018, and strongly endorse their arguments toward strengthening protections in the consumer credit legislation:

> *"frequent use of high-cost loans, debt spirals, and comparably high interest and fees – are … identified in our work. The Commission also receives anecdotal evidence from community advisers, who work with affected borrowers, that these issues … exacerbate the financial hardship experienced by their clients and dramatically escalate costs of borrowing beyond the point where borrowers feel that they have any practical ability to repay their debts."*[1]

Without a cap on interest rates, the Commerce Commission is hampered in its ability to provide adequate protection to financially vulnerable families in the current predatory environment. The Welfare Expert Advisory Group discussed this concern and solutions in their report Whakamana Tāngata.

Uncapped interest rates and debt spirals

Limit on the cost of borrowing

We support the 100% cap on the cost of borrowing, under clause 22 of the Bill, or section 45A of the proposed new legislation: "Costs of borrowing must not exceed loan advance".

[1] See https://comcom.govt.nz/__data/assets/pdf_file/0025/98260/Submission-to-the-Ministry-of-Business-Innovation-and-Employment-on-the-Review-of-Consumer-Credit-Regulation-1-August-2018.pdf, p. 10, paraphrased

The repayment cap is a good step to stopping debt spirals from high cost short term loans. This idea has been successful in Australia and the United Kingdom, but it has always been accompanied by other measures.

The need for an interest rate cap

Excessive interest rates have been a subject for concern for many years, and during the last review of this legislation, consumer organisations lobbied strongly for some control over interest rates to be introduced. We were heartened when the Minister of Commerce Kris Faafoi announced a review into the Credit Contracts and Consumer Finance Act. Submissions to MBIE's Discussion Paper from CPAG and the microfinance, financial capability and budgeting sectors were heavily in favour of an interest rate cap. The Minister signalled at that time that the review would consider an interest rate cap, so we are disappointed that the proposals by the Government only include a limit on the total cost of borrowing. Financial hardship can be caused before loans get to the 100% repayment cap.

The limit to the total cost of borrowing does not provide adequate consumer protection against irresponsible and predatory lenders. For example, in the case of very short-term loans, the weekly repayments can be extremely high without the total repayable reaching the 100% repayment cap. In the United Kingdom and Australia this measure has always been accompanied by other measures. Rates of 1.5% a day are common in New Zealand and this is almost twice the rate of 0.8% a day allowed in the UK.

In addition, an interest rate cap would force high cost lenders to be more responsible about the ability of the borrower to repay the loan. Recent investigations and prosecutions by the Commerce Commission have shown that many lenders are not complying with their responsible lending obligations. An interest rate cap would reduce lenders' freedom to cover the cost of borrowers defaulting because of their very high rates of interest. Lenders would be forced to lend more responsibly by carrying out extensive affordability assessments.

For the adequate protection of consumers, the Bill must include an interest rate cap. The maximum rate of interest could be 48% per annum as it is in Australia in relation to loans over $2,000. We argue that high cost loans do more harm than good and should not be available in the marketplace. Enabling someone already unable to repay one high cost loan to have access to a further high cost loan is not assisting them. It is increasing the depth and the speed of their debt spiral.

We acknowledge the concerns about access to credit, however, as the authors of the 2019 BERL report, 'The harm from high cost lending' state:

> *"Lending is an essential part of a functioning economy, but some loans do more harm than good."*[2]

We ask the committee to introduce an interest rate cap which restricts the interest that lenders can charge, similarly to the caps in the United Kingdom and Australia. We would like the Government to investigate how the UK and the Australian systems could apply in New Zealand. Either of these types of caps would mean that the families that we support are spending less money on interest payments and more money to spend on essentials such as food and housing.

Debt spirals from loans under 50% per annum

[2] Green, S, Robertson, N, Nana, G,, *The harm from high cost lending, Haratua 2019*, www.berl.co.nz, at https://berl.co.nz/economic-insights/community-development-retail-markets/time-rein-payday-lenders.

Debt spirals are not only caused by high cost short term lending. Other loans that have interest rates of under 50% per annum also cause debt spirals; such as motor vehicle loans, truck shop purchases and personal loans. We ask the committee to expand the scope of the proposed cap on the total cost of borrowing to apply to other expensive loans/loans above 30% p.a. at least.

Limit the percentage of income that can be spent on high cost loans

We recommend that no more than 10% of a borrower's income should go towards paying high cost loans. Clients should not have to spend their income on high cost loan repayments when this is needed for essential spending. This is important because users of high cost loans are typically low-income earners that have very little or no discretionary income.

Lenders should have the responsibility to ascertain what proportion of the borrower's income is going towards high cost loans. This is regardless of whether the high cost loan is spread over many lenders. Lenders should not be able to lend if the borrower is spending 10% of their income on high cost loan repayments. We are aware that Australia operates a similar prohibition for borrowers that are on benefits, where the maximum the borrower can commit to is 20% of income on high cost loans. Although the Australian cap is 20% of income, the Australian government is aware of the risks of this cap and there are efforts being made to change this to 10% of net income. This should be the law in New Zealand as well. This prohibition has had a significant impact on reducing the harm from high cost short term lending in Australia.

A loan register
Currently, apart from information provided by the borrower, lenders only know of the borrower's loan history with themselves. This may not give a complete picture of the borrower's commitments. Therefore, a register of high cost loans would be very beneficial to help lenders comply with the prohibition on borrowers committing more than 10% of income to high cost loans.

Equivalent protection for loan guarantors as borrowers

Experience with Ngā Tangata Microfinance has shown as that predatory lenders will ensure they have access to one or more guarantors for a high cost loan that is likely to be unaffordable for the borrower. The lender will then immediately and relentlessly pursue the guarantor when the borrower is unable to meet the repayments.

Truck shops and mobile traders

Banning mobile traders

We support a total ban on mobile traders. Clause 6 of the Bill has defined the term "mobile trader", which means that a ban on lenders who meet this definition is possible. Mobile traders' are predatory and deliberately target vulnerable communities, causing significant harm.

Including mobile traders under the credit contracts law

If our proposal for banning mobile traders is not accepted, we support the provision that covers credit arrangements used by mobile traders under the Act as consumer credit contracts. Often mobile traders have layby arrangements that are not currently considered credit contracts. This law change ensures that mobile traders will have to comply with the same laws as other lenders offering credit contracts.

Enforcement

We support all the changes to the Bill regarding enforcement. There needs to be stronger incentives for firms to follow the law.

In particular, we support pecuniary penalties and statutory damages to assist with compensation for irresponsible lending. They are helpful additions so that the Commerce Commission will be better equipped to take enforcement action against lenders.

Where there is a breach of the responsible lending principles by failing to make reasonable inquiries before entering into an agreement, clause 25 of the Bill allows for statutory damages equal to the interest charges, credit fees, and default fees that have become payable under the agreement. This is a particularly good addition.

However, strict liability offences should be created for certain oppressive behaviours such as failing to carry out adequate affordability assessment and offering extensions of credit in breach of the law (for example, beyond the 10% net income cap).

Borrowers are unlikely to enforce breaches because they are not in the best position to know what their rights are. If a borrower enforced breaches of the law, it is a slow and costly process. As consumer advocates we have ample skills to manage lenders and borrowers are unlikely to have the same skills.

We often refer cases to dispute resolution schemes. This is good for individual outcomes. However, more effective enforcement measures need to be in place for the Commerce Commission to be able to resolve disputes efficiently. We suggest that there should be a legal requirement for lenders to be obliged to refer a matter to their dispute resolution scheme if a borrower defaults within one month of taking out the loan. The early default suggests that the loan was not affordable for the borrower in the first place. The scheme can then investigate and if it appears to be a systemic problem, it can refer the matter to the Commerce Commission for more investigation. This would be a way of alerting the Commission to lenders that are not complying with responsible lending principles.

We also suggest that there should be a legal requirement to have to refer a borrower to a financial mentor before a loan is taken out if the borrower falls into the category of vulnerable borrower, for example, if they are in receipt of a benefit, or have defaulted on a high cost loan in the previous 12 months, or if they have taken out three or more high cost loans in the last twelve months. Then the mentor can work with the borrower to make sure they are aware of all their options and their rights.

Debt Collection

We support the disclosure requirement in the Bill which sets out the rights and obligations of the debtor at the start of the debt collection process.

While we understand that debt collection law might be outside the scope of the current Bill because it applies more widely than merely to high cost lending, we would encourage the Select Committee to recommend changes to debt collection law as a matter of urgency. Stronger law to control debt collection practices is required, and New Zealand is already significantly behind comparable countries.

Debt collectors should be regulated to prevent predatory collection practises. The law should cover contact, privacy and harassment issues. Harassment and high costs of collection are causing extreme emotional and financial harm to borrowers. People caught up in the process of debt collection are often vulnerable. The process of frequent and oppressive contact by debt collection companies can have very negative effects on the mental health of borrowers.

In Australia, the UK and the United States, extensive rules govern the way in which debt collectors can carry out their business. Many debt collectors currently active in New Zealand operate under the Australian regime and would not be disadvantaged by facing similar law in New Zealand.

Affordability Assessments

We support the strengthening of the current principle that lenders must make reasonable inquiries of a borrower so that the payments will not cause them substantial hardship. We support the change that lenders will need to verify information provided by borrowers.

We support the change that requires records to be kept about inquiries and those records to be made available to the Commerce Commission, the borrower, the guarantor, or the relevant dispute resolution scheme on request. Borrowers often find it difficult to obtain information about their loan and the assessments made which makes it more challenging to identify whether there has been a case of irresponsible lending.

Affordability assessments should also be required when mobile trader accounts are established. The product provided by a mobile trader is a “consumer credit contract” under the Bill and as part of this, the mobile trader should be obliged to assess whether the borrower can afford repayments.

More prescriptive affordability assessments will hopefully mean fewer borrowers will be taking out loans they will not be able to afford. We look forward to seeing the detail of what is proposed around prescription when the draft regulations are released.

We note that prescription around affordability assessments has been part of the law in Australia for several years, but the problem of irresponsible lending remains. The recent Senate Inquiry into Credit and Financial Products Targeted at Australians at Risk of Financial Hardship found that payday lenders were not complying with responsible lending obligations. This means that responsible lending obligations need to be supported by other measures. An interest rate cap, which exists in Australia, is a good start to force lenders to be more careful about who they lent money to, which requires thorough affordability assessments. Other measures that could help would be automatic referrals to the dispute resolution scheme and to a financial mentor, and more proactive enforcement by the Commerce Commission, as mentioned above.

Reasonable Fees

We support the strengthening of the current rules around reasonable fees. We support the requirements that creditors keep records about how fees are calculated and to make these records available to the Commerce Commission or the relevant dispute resolution scheme.

The prohibition against “unreasonable” fees is an inadequate measure as we have seen instances of this law being breached. Therefore, we support measures to make it easier to enforce the current rules around unreasonable fees.

Fit and Proper Person’s test

We support the Fit and Proper Persons test for creditors, mobile traders, and their controlling owners, directors and senior managers. It is beneficial for mobile traders to be included within this test because mobile traders often close when enforcement action is taken against them and reopen under new names. These are called “phoenix companies” and cause the same harm in the community. This measure makes enforcement against these types of lenders easier.

Advertising

Advertising for high cost short term loans must be banned or regulated as these extremely harmful products are advertised as desirable products. Advertising is often targeted at vulnerable communities through radio, local newspapers and the internet. Advertising for high cost short term loans should be regulated like other harmful products such as tobacco, where the social harm of the product is recognised.

We support the amendment that disclosure must be in the language that a loan was advertised in.

We support the strengthening of the advertising standards for all loans.

After Pay and emerging issues

We would support After Pay and equivalent post-pay schemes being included in the scope of the Bill, so that they are regulated in the same way as other credit-related loans. This is necessary as these products are very accessible and enable debt to build up very quickly. As was reported when ASIC, the Australian corporate regulator, welcomed the passage of legislation that gives it new powers to regulate buy-now-pay-later providers such as Afterpay and Zip Co.:

> *“In a report into the $903 million industry released in November last year, ASIC found one-in-six buy-now-pay-later customers had either become overdrawn, delayed bill payments or borrowed additional money to meet their payments…. ASIC says this will “bring accountability” to the industry, forcing providers to create products which meet consumer needs. The reforms will be phased in over two years and will require companies to identify customers they’re products are appropriate for, and subsequently, direct their distribution efforts to that market. Treasurer Josh Frydenberg said …. “These reforms mean consumers will be better protected from being sold financial and credit products that are not suitable for their circumstances,” he said in a statement.”*[3]

We support the call-in power that is proposed to be included in regulations to enable the government to bring these products into the scope of the Credit Contracts and Consumer Finance Act. We also recommend that the Commerce Commission or government undertake an investigation into the use of these products to assess the harm they are causing, especially now that they have become a recognised feature of retail shopping.

[3] See https://www.smartcompany.com.au/industries/retail/afterpay-zip-asic/.

Other issues

We advocate for an obligation to be placed on financial services providers to cooperate with financial mentors and budgeting services in defined ways, such as referrals to MoneyTalks, individual services, and provision of contact information to enable more effective advocacy.

We urge that it is made a legal requirement that lenders advertise the MoneyTalks service on their communications, particularly their websites. Legislation could ensure that this service is also promoted by lenders when a borrower is in arrears. This will open up greater opportunities to the borrower by encouraging more borrowers to discuss their money issues with qualified budget advisers/debt counsellors.

We recommend that there be a ban on the use of direct debit payment authorities by high cost lenders. There is no reason why the debt to the lender should be automatically deducted from the borrower's income. As a minimum standard, there should be ban on using direct debit authorities in the case of beneficiaries. These borrowers have very little income to cover daily expenses and the lenders use their powerful bargaining position to insist on taking first priority to the beneficiary's income. When direct debit's fail there are also additional bank charges that cause more hardship for the borrower.

Ngā Tangata Microfinance has had the experience of lenders with duplicates of direct debit authorities replacing the authority removed by the borrower with a duplicate.

Whakamana Tāngata

The Welfare Expert Advisory Group discussed some of these matters in their report Whakamana Tāngata (WEAG 2019).[4]

> *"….the impoverishment created by the payment of desperately inadequate levels of income and the related generation of debt to MSD and other sources. [For example: A lack of money increases stress and the likelihood people will make risky financial decisions. People use sources of financial support that they trust and avoid those where they feel judged and shameful (McFarlane et al, 2017; Sheehy-Skeffington & Rea, 2017). This can mean that people take out high-interest loans with third-tier lenders who make them feel welcome rather than seeking assistance from MSD which is perceived as being difficult to deal with.]"* (p. 85)

> *"We are concerned that a growing debt burden will undermine the ability of people and families receiving benefits to achieve the level of wellbeing intended through the social security overhaul recommended in this report. The level of indebtedness of many of those receiving benefits could result in increases in income being soaked up in high-interest and high-fee debt servicing. We support the rapid development of more stringent regulations on lending, particularly third-tier lenders, already under way. The debt burden presents a major obstacle in the achievement of the underpinning goal of whakamana tāngata, increasing the intrinsic wellbeing and dignity of the people."* (p. 86)

Conclusion

[4] Welfare Expert Advisory Group Report (2019). *Whakamana Tāngata. Restoring dignity to the Social Security in New Zealand*. Welfare Expert Advisory Group (WEAG). Available at http://www.weag.govt.nz/weag-report/whakamana-tangata/.

Thank you for considering our submission. We appreciate the extensive consultation that has taken place on this issue in 2018 by the Ministry of Business, Innovation and Employment. In addition to the amendments in this Bill, the changes we propose are necessary to prevent harm to vulnerable consumers. We ask the Finance and Expenditure Select Committee to introduce all these changes including the amendments in this Bill.

We particularly ask that the members of the Committee strongly advocate for the introduction of an interest rate cap. This would mean that this law would be effective in preventing debt spirals by making weekly repayments smaller and preventing irresponsible lending. This would help mitigate the harm borrowers are currently enduring as consumers of high cost credit.