MAXIM INSTITUTE

ISSUES PAPER

BEYOND THE SHADOW OF DEBT

SHINING A LIGHT ON HIGH-COST LENDING

'ALAPASITA TEU

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BEYOND THE SHADOW OF DEBT: SHINING A LIGHT ON HIGH-COST LENDING

'ALAPASITA TEU

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For many New Zealanders the consumer credit lending experience is generally positive, with many credit lenders complying with regulations. Credit law reforms including the recent changes to regulations signal a commitment from the government to ensure lenders are diligent in their duty of care towards consumers. However, our concern, despite the current credit laws, many vulnerable families and communities continue to be exploited through irresponsible and harmful lending practices, most often through short-term high-cost loans.

Changes to consumer credit regulations have gone some way towards increasing protection for borrowers and ensuring a safer consumer credit lending environment for individuals, whānau, and communities. But regulatory gaps remain, leaving opportunities for lending practices that contribute towards financial hardship and unmanageable debt to continue. On the contrary, these are opportunities for policy changes and for us to do better.

This Issues Paper examines the consumer credit market identifying the ongoing issues despite the recent changes to consumer credit regulations. The following are ongoing areas of concern that require attention and policy changes.

1. **Irresponsible lending practices** – Current evidence of irresponsible lending practices include failing to exercise care and due diligence in dealings with borrowers, non-compliance with affordability assessments such as providing loans with minimal consideration for a borrower's ability to repay debt.
2. **Poor debt collection practices** – Debt collection encompasses all recovery actions undertaken by a lender in the event of missed payments and after a borrower defaults on a consumer credit contract. Debt collectors and agencies either act on behalf of the person or company seeking owed money, or purchase the debt to recover on their behalf. There is very minimal regulation of the debt collection industry or debt collection practices in New Zealand.
3. **Financial exclusion: Lack of accessible and safe credit** – The concept of financial exclusion is often narrowly defined as an inability to use mainstream banking and financial services. People who experience financial exclusion have less agency in financial options, leaving them more likely to seek harmful lending sources that offer more complex financial products and more aggressively advertised services. They are more susceptible to high-cost loans and lack the assets, savings, and financial safety nets for buffering emergencies.
4. **Buy-now-pay-later (BNPL) schemes** – Unlike traditional loans credit cards, BNPL is a modern-day version of traditional lay-buy. Essentially a hybrid version of a credit card with less administration and without interest. At present there is no direct regulation of BNPL schemes. The easy access to interest-free credit is a slippery slope for encouraging unaffordable spending and is a pathway to problem debt.

Our recommendations in full:

Recommendation 1: Increase investment in Microfinance credit with wrap-around support

Microfinance provides alternatives to high-cost credit helping people meet their financial needs while minimising risks of them falling into unmanageable debt. Borrowers are provided with financial support and credit with terms and conditions that are fair and affordable.

Recommendation 2: Maintain increased government funding for core Building Financial Capability (BFC) services

The increased financial government support from government throughout the COVID-19 pandemic should be retained to resource services under the BFC sector that includes financial mentoring services, community organisations and iwi that deliver budgeting services and financial education.

Recommendation 3: Include Buy-Now-Pay-Later in the scope of the Credit Contracts and Consumer Finance Act 2003 (CCCFA)

The Minister of Consumer Affairs and Ministry of Business, Innovation and Enterprise should review out of scope lending such as Buy-Now-Pay-Later schemes to be included under the CCCFA's regulatory scope. Regulation of the BNPL industry would mean increased consumer protection.

Recommendation 4: Develop a licensing framework for debt collection agencies and collectors

The Commerce Commission should develop a national licensing scheme for debt collection agents and agencies with lead oversight from the Commerce Commission, and working alongside dispute resolutions schemes.

Recommendation 5: Increase the regulatory functions of the Commerce Commission

Strengthen the regulation of consumer credit lending requires an expansion of the Commerce Commission's regulation responsibilities to include a regular or annual audit of all high-cost credit lenders.

Recommendation 6: Develop a centralised database for high-cost loans

To support the function of new legislative regulations to the Responsible Lending Code, the Ministry of Business, Innovation and Enterprise should develop and introduce a national database of high-cost, short-term loans.

Recommendation 7: Maintain ongoing support for the National Strategy for Building Financial Capability (BFC) 2021-2024

We recommend ongoing government and finance industry support for nationwide solutions such as the National Strategy for Building Financial Capability (BFC) 2021-2024 led by *Te Ara Ahunga Ora:* Retirement Commission.

Changes to consumer credit laws since the enactment of the primary legislative and regulatory framework demonstrate that in the absence of fit-for-purpose statutes and regulations, conditions for harmful lending practices can leave the lending landscape a bit like the Wild West. The policy recommendations we outline in this paper seek a responsible, fair, and more effective lending environment. We offer practical measures that bolster existing policies where they are succeeding, and regulatory mechanisms to increase consumer protection and reduce financial hardship where they are needed.

1. INTRODUCTION

> *"You're inundated with all this debt, and you just keep going with all this debt. You might have stuff, but you're in debt. You're swarming in debt. You're never going to get out of it. Or you think you're never going to get out of it. It was so overwhelming. It was like the dark shadow that always just followed me."*
> *– Casey, Christians Against Poverty (CAP) client*

For many New Zealanders debt is manageable, a normal part of participating in our economy. For others like Casey, debt can be debilitating, affecting their health and mental wellbeing. This is likely to lead to "unmanageable debt leading to financial strain," commonly known as problem debt.[1]

Debt hits those with the least the hardest—inundated, swarming, overwhelming. As the Families Commission highlighted, "debt can potentially be a problem for any family in New Zealand, but it is likely to be worse for families who are on limited incomes; are without assets; do not possess the skills and resources needed to get out of debt, and whose options to improve their financial situation are limited."[2] They are more likely to be on low-incomes, have limited financial and human capital, have poor money management and financial literacy skills, and are more prone to living with socio-economic deprivation.[3] Other associated factors include having multiple debts, experiencing financial hardship and reduced access to mainstream lending.[4]

People may fall into unmanageable debt due to individual or to systemic factors. These include inadequate income to meet basic needs, rising living costs, low financial literacy levels, borrowers' spending behaviours, debt to Government, and significant changes in circumstances such as a job loss.[5] People's behaviours are often thrown into the spotlight when it comes to problem debt, but systemic factors such as financial systems, financial products, and the consumer credit lending market have until recently tended to receive less attention.

Since the mid-2000s, New Zealand's consumer credit laws and regulatory mechanisms have undergone significant changes that target unscrupulous lending and irresponsible lenders.[6] Policymakers and legislators have tried to minimize harmful lending practices whilst maintaining competitive and efficient credit markets. The introduction of the Responsible Lending Code (the Code) alongside responsible lending provisions such as loan affordability assessments and disclosure requirements of fees and interest rates signal a shift towards a more protective regulatory regime. Other supplementary documents aimed at assisting borrowers include the provision of guidelines such as a Credit Fees Guidelines and Disclosure Guidelines and Repossession Guidelines through to a Responsible Borrowers Code outlining the rights and responsibilities of individuals engaged in consumer credit services.[7]

The consumer credit lending experience is generally positive, with most lenders complying with laws and regulations. Our concern, however, is that despite the current consumer credit laws, many vulnerable families and communities continue to be exploited through harmful lending practices, most often through high-cost, short-term (HCST) loans.

The changes to consumer credit regulations have gone some way towards increasing protection for borrowers and ensuring a safer consumer credit lending environment for individuals, whānau, and communities. Credit reforms including recent sweeping amendments to the primary regulatory framework signal a commitment from government to ensure lenders are diligent in their duty of care towards consumers.[8]

But regulatory gaps remain, leaving opportunities for lending practices that contribute towards financial hardship and unmanageable debt to continue. We can do better.

In this Issues Paper we examine the consumer credit market, drawing attention to the issues that arise from loosely regulated aspects, and making suggestions regarding how to keep borrowers safe. We describe the consumer credit lending spectrum, focusing on high-cost consumer credit and borrowers, and outline the primary consumer credit regulatory framework including an overview of the relevant regulatory entities and recent changes to consumer credit laws and regulations. Following that, we briefly assess the recent amendments to the principal consumer credit legislation to build a picture of the current state of consumer credit regulation, and outline the ongoing issues in light of these changes. We conclude with a set of recommendations aimed at addressing the gaps in consumer credit regulation, minimizing ongoing consumer credit lending issues and reducing harmful lending.

2. BACKGROUND

2.1 High-cost consumer credit

Consumer credit is credit for individual and personal use, distinct from that used for business or investment purposes.[9] Forms of consumer credit or consumer credit products include credit cards, personal loans, hire purchase agreements, vehicle financing, student loans and mortgages, and, increasingly, buy now pay later (BNPL) schemes. In other words, it is a personal debt taken out for personal use, be it a car loan or domestic goods, everything from whiteware to daily living goods.

In the New Zealand context, high-cost credit is often understood as loans with interest rates of 50% or more per annum.[10] The term high-cost credit can be contentious considering the inherent risks of lending. Within this paper we refer to its definition in Consumer Credit and Contracts Finance Act (CCCFA) 2003 and the Responsible Lending Code (The Code). The legislative and regulatory framework defines a high-cost consumer credit contract as:

(a) a consumer credit contract—

(i) that provides for an annual interest rate of 50% or more; or

(ii) under which the weighted average annual interest rate applied to the unpaid balance is, or is likely to be, 50% or more on any day during the life of the contract; and

(b) includes a contract declared by regulations to be a type of contract that is a high-cost consumer credit contract.[11]

This form of credit has several distinguishable features compared to other financial products: primarily short time frames that include contract processing times and same-day access to funds and high costs that accumulate over time due to high interest rates and fees in a credit contract. They are often designed to bridge short-term cash flow issues where repayments are assigned to commence on the borrower's next pay day, hence the term payday loans.[12] Before the latest credit reform, definitions of high cost loans noted differences from standard finance loans including high-cost lender rates, ranging from 100-400 percent per annum for a 3-12 month loan to hundreds of percent interest per annum for a short (under six-week) loan.[13] Whilst this definition may no longer be applicable, it is important to note exorbitant interest rates and fees are common features of high-cost loans.

Box 1: Terms for reference

CCCFA 2003: Credit Contracts and Consumer Finance Act 2003

Consumer credit products: Credit contracts offered and payable with interest and a credit fee contract, where the contract's total costs accumulate over time depending on the interest.

Consumer credit Contract: Contracts where arrangements are made in which credit is provided for personal, domestic or household purposes. This includes payment of interest, credit fees or taking of a security interest.

Financial products: consumer products in which an individual makes a financial investment (shares), borrows or lends money (loans and bonds) and/or saves money (term deposits). These products are issued by banks, financial institutions, finance companies and governments.

High-cost short-term loans (HCST): Short-term consumer credit (often 6-12 months) with interest rates over 50% per annum.

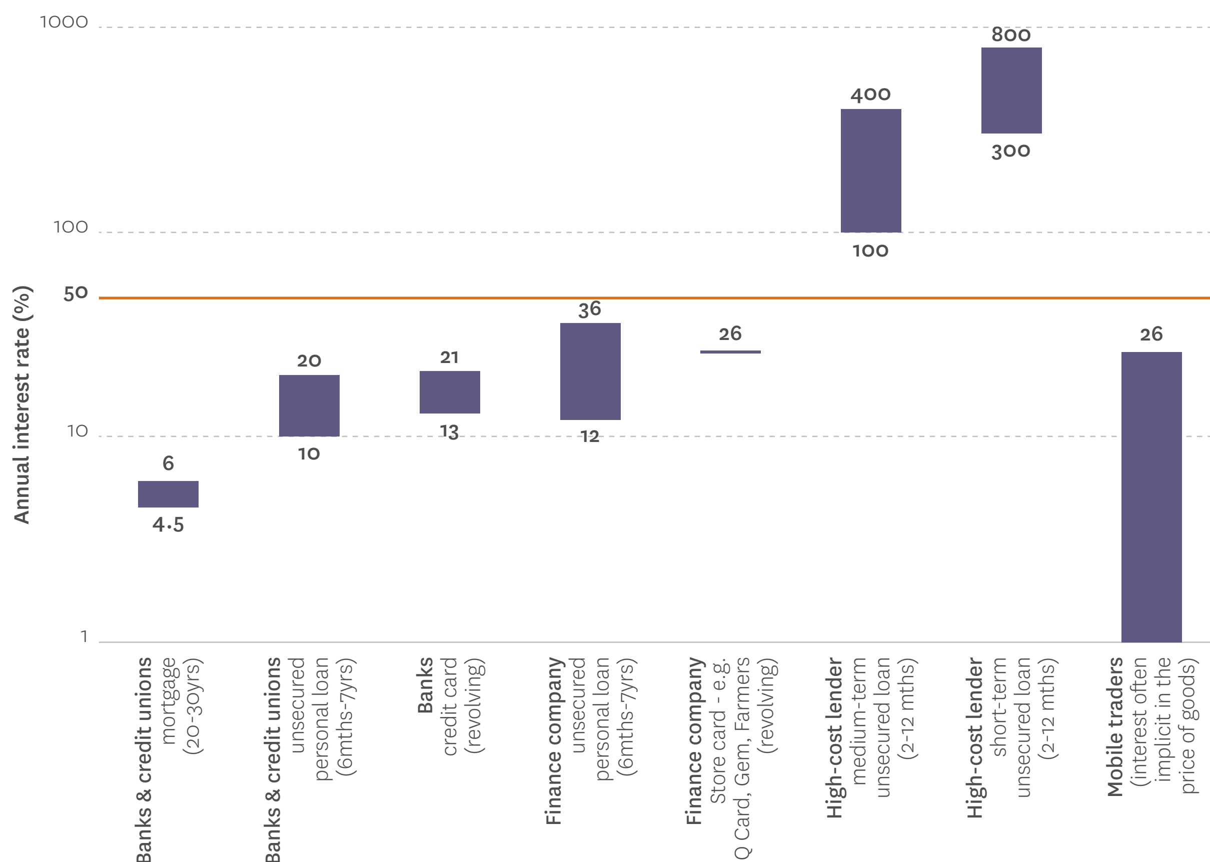
Payday lending: Consumer credit lending in the form of short-term loans where repayments are made over four to six weeks.

Secured loan: A loan whereby an assest such as a house or vehicle is used as security to secure the loan.

Unsecured loan: A loan with no requirements of any assets.

Source: Ministry of Business, Innovation and Enterprise,[14] and Consumer Law.[15]

Figure 1: Interest rates across different lending institutions*



Source: Ministry of Business, Innovation & Employment (MBIE), 2018.[16]
*Note: The y-axis is on an exponential scale

2.2 High-cost, short-term loans borrowers

Understanding the context and factors shaping the relationship between a borrower and high-cost credit gives insights both into the regulatory gaps and opportunities for solutions. As HCST credit often falls outside of mainstream lending products offered through banks and credit unions, it is also helpful to discuss who typically accesses HCST credit.[17] In general, these borrowers are more likely to be on low incomes, unemployed, be beneficiaries, have existing debts and poor credit history, non-English speaking, belong to indigenous and ethnic minority groups, and have low-levels of literacy.[18] Reports on financial hardship have noted that of those seeking help from budgeting services concerning unmanageable debt issues and high-cost loans, women tend to make up a large portion.[19] Across the consumer credit and financial capability literature, frequent high-cost credit users are often understood as borrowers in vulnerable circumstances,[20] and are more prone to debt traps resulting from accumulating debt from interest and fees on loan non-payments.

Unfortunately, the availability of high-cost credit is often accompanied by factors that strengthens its niche in the credit market including insufficient income for necessities, precarious work or frequent job loss, illness or a budget shortfall resulting from unexpected financial costs.[21] Unmanageable debt which in turn leads to problem debt can affect individuals at any level of income. However, its impacts are more detrimental to users of HCST loans.[22] A Business, Economics and Research Limited (BERL) report on the harms of high-cost lending highlighted 98 percent of borrowers with high-cost loans utilizing FinCap (a financial mentoring service) often had a median of six debts.[23] Of the borrowers,[24] over 50 percent had at least one debt with Work and Income New Zealand and 27 percent identified high-cost loans as a cause of financial distress.[25]

For this group of borrowers, circumstances and lifestyle factors may contribute to their uptake of high-cost loans. For some individuals and families, the shortfall from unforeseen expenses such as car repairs, the need for larger household appliances, and social and cultural obligations drives their need for high-cost and short-term loans. For others, job loss and ongoing insufficient incomes to meet essentials such as rent and food costs steers them towards easy to access high-cost, short-term consumer credit.

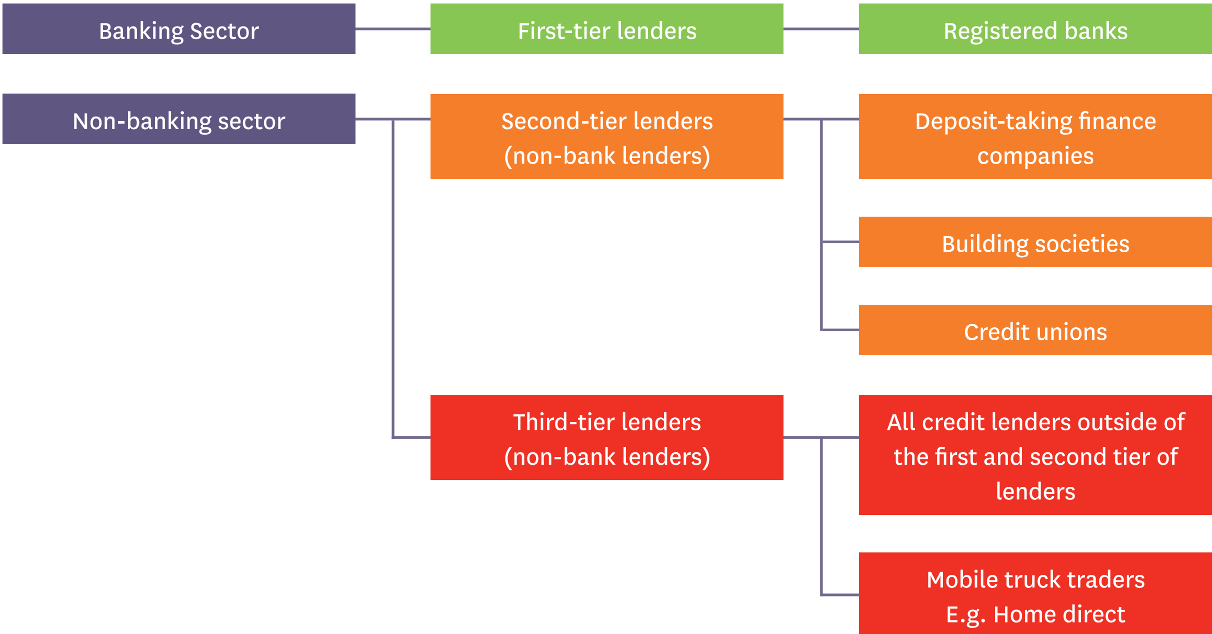
2.3 The Consumer Credit Lending spectrum

New Zealand's consumer credit market is a vast and diverse industry operating within a nexus of businesses, financial services providers, domestic and global credit markets, regulatory bodies, and legislation. Credit lenders and their operations are commonly understood within a three-tiered system.[26] Whilst not a legal definition, the tiered classification system categorises lenders according to the type of financial institution (bank or non-bank), the business size (volume of lending services and size of the organisation) and lending portfolio (types of lending services and credit products offered).

Higher-tiered lenders tend to be more extensive and established financial institutions inclined towards secured lending, steering clear of any form of risky lending such as short-term, high-cost loans. Credit provision on the lower tier of the lending spectrum sits within the non-bank sector and caters to high-risk, unsecured lending and higher borrowing costs. All three tiers are subject to lender regulations and guidelines outlined in the Credit Contracts and Consumer Finance Act 2003 (CCCFA) and the Responsible Lending Code. The implementation of regulation differs across the tiers depending on the nature of credit lending practices and credit products.[27]

First-tier lenders are larger financial institutions, primarily registered banks. At present, 27 registered banks provide most lending services in New Zealand, primarily for businesses and residential mortgages. [28]As more established financial institutions, first-tier lenders observe more stringent regulations and reporting requirements that may not always apply to non-bank lenders. Credit lending within this tier offers consumer credit products such as credit cards, long-term home loans, and personal loans instead of short-term, high-cost loans. Subsequently, these consumer credit lending services are limited to individuals with a good credit history and secured assets; those seen as low risk borrowers.

Figure 2: Consumer credit lending institutions



Second-tier lenders are broader, consisting of savings institutions, credit unions, and deposit-taking finance companies. Unlike the banking sector, second-tier lenders are not subject to the same registration or reporting requirements but are governed by regulations outlined in the Building Societies Act 1965 and Credit Unions Act 1982.[29] Credit unions and building societies function similarly to banks but are non-bank depositors regulated and monitored by the Reserve Bank of New Zealand. Cooperatively owned credit unions and building societies offer similar products to banks and tend to offer lending for business, residential mortgages, and property investment.[30] The difference, however, lies in the funding model where members provide assets that subsequently offer credit.[31]

Historically, second-tier lending services have included secured and unsecured loans. After the 2008 Global Financial Crisis monetary policy reshaped aspects of lending industry,[32] in particular the absorption of second-tier lending services by other tiers. A lowered Official Cash Rate (OCR) provided opportunities for expanding business and residential loans by registered banks.

Third-tier lenders are finance companies on the lower end of the lending spectrum whose lending services include high-cost, short-term loans. Credit products and loans offered through this tier of lending are often labelled as "high-cost" due to their high annual interest rates in comparison to mainstream lenders such as banks and credit unions.[33] This tier of the consumer credit market is also commonly associated with harmful lending, HCST loans in particular.[34] Third-tiered lenders often attract individuals who fail to meet first and second-tier lending requirements or the mainstream lending criteria. Credit lenders in this group all fall outside the first two tiers, and include mobile lending trucks, pawn shops, high-cost lenders, and non-first and second-tier financial companies. The growth in demand for HCST loans is in part powered by the ability of non-deposit taking companies to issue loans faster than second tier lenders. The growth in the supply of HCST loans reflects the ability of third tier lenders to borrow from registered banks at low interest rates, increasing their ability to provide consumer credit.

3. CONSUMER CREDIT REGULATION

3.1 Regulatory Entities

Regulation of consumer credit services is an enormous task, shared among various regulatory entities. In conjuction with consumer credit legislation and lending regulation requirements, the Commerce Commission, dispute resolution schemes, and the courts form the nexus of consumer credit regulators. Each stakeholder has a distinct role in monitoring and managing financial complaints and disputes between consumers, credit providers, and other relevant stakeholders such as budgeting services.

3.1.1 The Commerce Commission

The Commerce Commission is the primary regulatory agency responsible for enforcing consumer laws, guidelines and regulations related to competition, fair trading, and consumer credit contracts. The Commission's regulatory responsibilities include electricity lines, gas pipelines, telecommunications, dairy and airport sectors.[35] Other roles include promoting competition in various industries and protecting consumers through enforcing regulations, acting as an intermediary between consumers and businesses, and providing consumer protection and safety information.[36]

3.1.2 Dispute Resolution Schemes

Four approved schemes provide dispute resolution services for domestic financial services and a free service for consumers.[37] Consumer credit lenders are required to be a member of one of the four schemes: Banking Ombudsman (BOS); Insurance and Finance Services Ombudsman (IFSO); Financial Services Complaints Ltd (FSCL); and the Financial Dispute Resolution Service (FDR). These private companies and independent bodies act as intermediaries between borrowers and their scheme members, providing alternatives to legal proceedings to resolve financial complaints. All dispute resolution schemes are required to meet compliance requirements outlined in the Financial Service Providers (Registration and Dispute Resolution) Act 2008, such as being accessible, independent, and fair.[38] In the absence of an industry standard of dispute resolution guidelines, each scheme develops and enacts its individualised processes and management of consumer complaints and resolutions.

3.1.3 The Courts

Consumer credit disputes, where a lender and borrower cannot reconcile, can be settled through the courts. Breaches of consumer credit lending regulations that include lender misconduct fall under the courts' rulings. The courts also issue attachment orders for unpaid debt and the newly introduced lender penalties and statutory damages around breaches of lender responsibilities. Resolving financial disputes through the courts can be arduous and costly for borrowers, perhaps explaining credit lenders' higher uptake of court services than borrowers.

3.2 The Credit Contracts and Consumer Finance Act 2003 (CCCFA)

3.2.1 The legislation (CCCFA)

Statutes in the Credit Contracts and Consumer Finance Act 2003 (CCCFA) regulate consumer credit in New Zealand.[39] Regulation also includes other legislation such as the Fair Trading Act 1986, the Consumer Guarantees Act 1993, and the Financial Markets Conduct Act 2013.

"The primary purpose of this Act is to protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land," and regulate consumer credit contracts.[40] Its functions include providing responsible lending principles and the Responsible Lending Code - a guidance document governing the implementation of lending principles.[41] The legislation includes guiding principles around disclosure requirements, fees and payments, debt collection and repossession, enforcement and remedies, and now certification requirements for managers and directors.[42]

3.2.2 Consumer credit reforms

Over the past two decades, the primary consumer credit law (CCCFA) has undergone several reforms to create fair, adequate, enforceable, and understandable consumer laws for consumers and businesses.[43] A significant focus of consumer credit law reforms has been increasing consumer protection against irresponsible lending and regulating consumer credit contracts (See Figure 3 below for a timeline). This has included introducing responsible lending provisions against charging unreasonable credit or default fees and prescriptions such as disclosure requirements.[44] Here, lenders are required to disclose

specific information in consumer credit contracts, from the length and total cost of a loan, the interest rate, any additional fees and contract clauses around debt repossession and refinancing processes if the individual misses loan payments. Essentially, lenders provide borrowers with as much contract information as they need, so they can borrow with confidence. These requirements promote transparency around credit contracts and debt acquisition in a competitive credit market, and subsequently minimise the dangers of asymmetrical information through increased access to accurate and reliable information.

In 2015, consumer credit law reforms introduced prescriptive regulations related to disclosure requirements, a responsible lending framework and incorporated repossession laws.[45] The new provisions required lenders to ensure credit contracts are suitable and affordable for the borrower, the availability of disclosure statements to borrowers, and introduced new debt collection and repossession requirements.[46] Lenders are required to exercise care and diligence with services and credit products, provide suitable and affordable credit products, assist borrowers in making informed decisions, and ensure ethical and reasonable treatment towards borrowers during the loan duration.[47] Further prescriptive provisions around lending principles and responsibilities were included through the Responsible Lending Code.[48] Due to the principles underpinning the lender responsibilities, the Code sought to provide practical guidelines for implementing and meeting lender obligations.

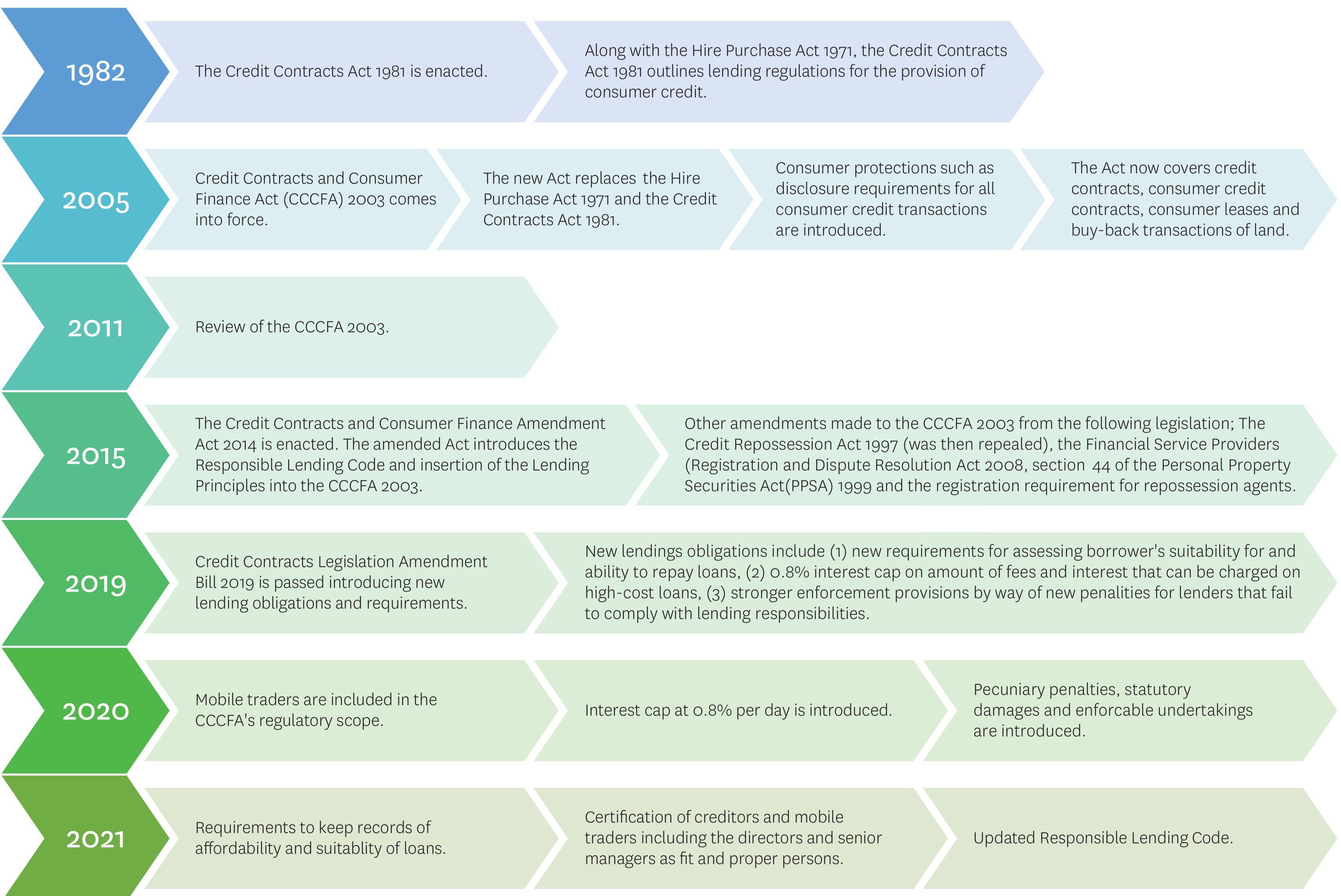
Government reviews of the 2015 credit reform noted an increased awareness of irresponsible lending practices by both lenders and community service providers.[49] Improvements such as disclosed interest rates and fees on lender websites, and the use of clearer and plain language in credit contracts, were also observed.[50] However, community providers and consumer advocates highlighted concerns around continuous irresponsible and harmful lending. They were concerned about the provision of high-cost consumer credit, particularly in low-income communities; continued irresponsible lending practices in the form of non-compliance with affordability assessments; and excessive costs of some consumer credit contracts.[51]

3.2.3 The CCCFA today

The Credit Contracts Legislation Amendment Bill 2019 introduced by the Minister of Consumer Affairs aimed to address ongoing concerns around harmful lending practices such as non-compliance with advertising standards, particularly loan affordability assessments and high-cost loans.[52] The flurry of amendments to the CCCFA 2003 took a more targeted approach towards curbing harmful lending and increased protection of borrowers, particularly against financial harm and hardship that leads to problematic debt. These new regulatory measures include:[53]

- The incorporation of mobile traders within the regulatory scope of the CCCFA 2003 legislation;
- financial penalties of up to $600,000 and more severe penalties and statutory damages for irresponsible lending;
- an interest rate cap whereby the total daily charge of interest and fees added to the high-cost loan will not exceed 0.8 percent of the credit provided per day;
- prohibitions on compound interest and a total cost cap on default fees are limited to 100 percent of the original loan amount. E.g. if the original loan is $500, the total repayment amount (including fees and interest) cannot exceed $1000;
- prescriptive requirements for affordability and suitability tests, new rules around disclosure and advertising standards, credit lender-hopping, and pecuniary penalties for legislative breaches;
- new compliance requirements including a fit-for-purpose certification for directors and managers of lending services; and
- new annual reporting requirements for directors and managers of credit lenders to include annual reporting requirements to the Commerce Commission, with specific information around debt collection practices and fees.

Figure 3: Timeline of consumer credit law reforms



3.3 An assessment of the recent amendments to the CCCFA 2003

As previously outlined, recent amendments to the consumer credit regulatory framework aim to place more responsibility on lenders to enhance protection of consumers. The current provisions in the CCCFA including recent amendments do well to address ongoing issues such as poorly conducted loan affordability assessments, poor debt collection practices, and the provision of unaffordable high-cost loans.

These are all constructive steps that may indirectly impact the low-barrier entry into the high-cost consumer credit market by introducing provisions to increase lender accountability. The introduction of tougher penalties and statutory damages for breaches of Lender Responsibility Principles reinforces efficient enforcement of the CCCFA and the Commerce Commission's regulatory powers.

The stricter regulations and compliance settings help promote safer and ethical lending practices that may reduce the growing trend of harmful lending practices. However, increased compliance and registration requirements mean increased administration costs. These costs increase lenders' financial burden, potentially limiting profit margins and the appeal of entering the credit industry, particularly for high-cost lenders. This may help minimise unscrupulous lending and drive out non-compliant credit lenders.

Despite recent amendments to consumer credit laws, they remain prescriptive and principle-based which poses difficulties around enforcement. Stronger enforcement provisions are still required to bolster the consumer credit regulatory framework.[54] For example, more explicit definitions of coercion regarding debt collection guidelines are needed without a centralised debt collection governing entity. This extends to ambiguous provisions in the CCCFA left to a lender's discretion such as loan affordability assessments and hardship requirements.

More generally, some of the obscurely defined CCCFA provisions need more clarity and consistency. In the absence of more definitive language particularly around the responsible lending principles, supplementary information regarding their application is necessary. This can be provided alongside the Responsible Lending Code or incorporated into the Code. In addition, the principles-based Code remains non-binding, creating challenges for regulatory enforcement and contributing to lender non-compliance issues.[55]

4. ONGOING ISSUES

Consumer credit reforms over the years have sought to address issues around harmful lending and its impact on some borrowers. Consumer credit-related issues such as irresponsible lending practices and dubious debt collection practices tend to make up a large proportion of consumer complaints to the regulators, including the four financial dispute resolution schemes and the Commerce Commission.[56] Despite the regulatory changes such as the introduction of the Responsible Lending Code stipulating prescriptive lending provisions around credit contracts, fees and interest, and the Commerce Commision's enforcement function, we still have concerns around irresponsible lending practices, poor debt collection practices, financial exclusion, and buy-now-pay-later schemes. There is more work to be done.

4.1 Irresponsible lending practices

Most consumer credit lenders demonstrate compliant lending practices. However, loosely regulated aspects of the credit industry have provided opportunities for irresponsible lending over the past two decades.[57] Limited data, particularly data on irresponsible and unethical lending, make it challenging to capture the industry's size and positive and negative trends. However, available data have shown that non-bank lending institutions (including payday lenders) have increased by 39 percent—almost $1.5 billion in nominal terms between 2014-2019.[58] Evidence of irresponsible lending practices is often drawn from complaints received by the Commerce Commission, Dispute Resolution Schemes, and financial lenders surveys.

According to an MBIE survey, there were high levels of non-compliance with the Lender Responsibility Principles, with 21 percent of the 215 lenders surveyed failing to meet lending obligations under the CCCFA 2003.[59] Additionally, 58 percent of lenders offered more than 20 percent rates, with 19 percent advertising interest rates above a hundred percent. Revenue and profit increases noted above can also indicate a growing third-tier market and an increase in harmful lending practices. It also points to a fringe lending market where "consumers are more likely to suffer detriment in the form of harsh and oppressive contracts, high-interest rates, fees and penalty charges, and subsequently high levels of indebtedness."[60]

The Commerce Commission's 2017-2018 Consumer Issues survey reported common complaints centred around irresponsible lending practices, disclosure and fees, and debt collection.[61] The Mobile Trader 2014/2015 Project highlighted 31 of the 32 surveyed lenders failed to meet legislative credit lending regulations with mobile traders.[62] Mobile trader complaints featured more prominently in credit complaints to the Commerce Commission combined with community organisations' feedback.[63] Reports from various debt solutions providers and financial mentoring services echo similar findings, noting that irresponsible lending practices are rife.[64] Irresponsible lenders tend to target borrowers that may not fully understand the gravity of the consequences of signing a credit contract.

Recent amendments to the consumer credit regulatory framework, noted in Section 3.2, aim to place more responsibility on lenders whilst enhancing the protection of consumers. Individual borrowers are the primary beneficiaries of new regulations such as the limit on debt accumulation on single loans, and limits on interest accumulation on high-cost loans. Third-tier lenders, particularly fringe lenders, are now subject to increased compliance and administrative costs. Consequently, limitations on interest rates and accreditation costs, with additional outgoing expenses and limited profit margins, may drive non-complaint and unscrupulous lenders out of business.

4.2 Poor debt collection practices

Research from Victoria University suggests that the lack of regulation around repayment schedules enables poor, and potentially oppressive, debt collection practices.[65] Debt collection encompasses all recovery actions undertaken by a lender in the event of missed payments and after a borrower defaults on a consumer credit contract. Debt collectors and agencies either act on behalf of the person or company seeking owed money, or purchase the debt to recover on their behalf. Common types of debt that result in debt collection include utility bills, fines, and loans.[66] Debt collection agencies are subject to specific rules under the Fair Trading Act, Anti-Money Laundering and Countering Financing of Terrorism Act 2009, and some obligations under the CCCFA 2003.[67] Debt collectors (agents and purchases) must comply with privacy principles under the Privacy Act 1993.[68]

Missed loan repayments incur additional fees and require a repayment schedule agreed upon by the borrower and creditor. These agreements are often dictated by the creditor or debt collector, which in turn may exclude considering the borrower's interests. In some cases, collectors may turn up at borrower's workplace to make unrealistic payment demands, potentially resulting in a borrower agreeing to unrealistic repayment demands to avoid further dealings with debt collectors.[69] Repayment schedules are often unaffordable, unrealistic, and place the borrower in further financial hardship and under unnecessary additional stress.[70]

The 2018 MBIE consumer credit review reported growing evidence of poor debt collection practices by some debt collectors in New Zealand.[71] Evidence included practices such as: "frequently including false and misleading claims, harassment, excessive charges, and unrealistic payment demand" to examples of aggressive and coercive behaviour by debt collectors.[72] Debt collection reports from organisations in the debt solutions and financial mentoring sectors such as Fincap noted similar findings such harassment over the phone, including calling individuals at work, threats of court action/repossession, to tracking individuals through social media. [73]

A report by Christians Against Poverty (CAP) gives a picture into debt collection experiences captured in the following excerpts from clients.[74]

> *"I used to get calls left, right and centre. If I happened to be behind just one payment and stuff, they just wouldn't stop calling, ringing."*
> *– Api, CAP client*

> *"I was constantly getting phone calls at work or wherever from people saying, "where's my money, where's my money?" That was getting a bit embarrassing at work too, cause you know I didn't tell them what the problem was, but it's really awkward when you're getting harassed by people for money that you just don't have."*
> *– CAP client*

> *"I know now [as a debt coach] why our clients don't answer the phone, that's the exact same reason why I didn't. You try and hide from that... It's so overwhelming when people contact you demanding money... It starts off with the niceness, but then it can turn...some conversations I've had with creditors, they'd be quite mean."*
> *– Former CAP client*

> *"They [creditors] were relentless.... It was just awful and every time the phone would ring, you'd see no caller ID... I just dodged it. Just didn't answer. I was just jumping out of my skin every time the phone rang and oh no, it was horrible, absolutely horrible." – Mark and Carol, former CAP clients*

> *"We have had a situation where this creditor actually went to this client's place of work and demanded that they see them. They really bullied this guy, basically threatened him so much that he forced him into signing up a repayment plan right there and then... Such was the force and this intimidation that he had on the client that he just kept out to it and ended up signing a repayment plan." – Ian, CAP Debt coach*

The CAP report echoed similar findings to previously mentioned debt collection reports with evidence of harassing behaviour in the form of robotic, automated phone calls multiple times a day to debt collection visits to threats to disclose owing debts to workplaces, family, and friends.[75] These poor practices adversely affect vulnerable consumers such as people with mental or physical health issues, low literacy, and limited English.[76]

Current debt collection regulations do not explicitly state how often a debt collector can contact a borrower, enabling debt collectors to hassle borrowers with calls and messages. With no regulations around the frequency of visits, this inadvertently contributes to borrowers' additional fees for follow-up contact and visits. These fees are often written into a credit contract using generalised, catch-all language like "all costs associated with debt collection will be borne by the debtor."[77]

While some collection costs are listed in a credit contract, many of the expenses can be hard to understand, and it is not clear when these fees may apply. Incoming amendments to consumer credit laws now require debt collectors to show information regarding the collected debt, including payment plan changes to the original debt contract. Submissions on the 2018 consumer credit review emphasised the need to address debt collection

issues, specifically harassment and coercion,[78] yet their pleas were overlooked. MBIE argued their lack of action to reduce intimidation and harassment was due to the unintended effects and harms on borrowers such as court action and the reduction on debt recovery rates.

Considering debt owed to government from citizens is acquired through the debt collection industry, any law changes concerning debt collection and repossession becomes complex and challenging. Despite a surge in complaints, unethical and harmful debt collection issues are likely to remain under-reported due to consumers' fear of retribution, shame, and lack of knowledge of rights and the complaints processes. The absence of stringent debt collection provisions particularly about poor conduct and mandatory conduct and compliance requirements, fails to recognise the serious nature of poor debt collection practices, including its adverse effects on borrowers.

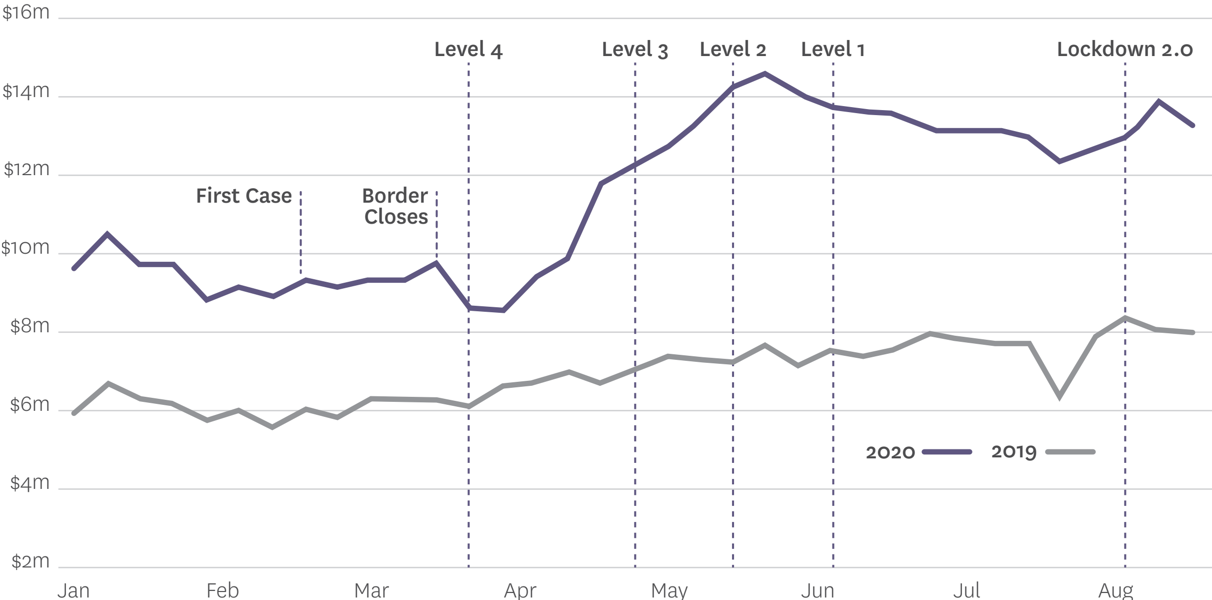
4.3 Financial Exclusion: Lack of accessible and safe consumer credit

The concept of financial exclusion is often narrowly defined as an inability to use mainstream banking and financial services.[79] This generally applies to two groups of borrowers: people who cannot access consumer credit due to an inability to service the debt, and people who may access credit products but face restrictions due to credit history circumstances.[80] However, the following comprehensive definition better reflects the complex nature of financial exclusion, and highlights the need for measures to consider holistic services and broader structural change:[81]

> *Financial exclusion is a process whereby a person, group or organisation lacks or is denied access to affordable, appropriate and fair financial products and services, with the result that their ability to participate fully in social and economic activities is reduced, financial hardship is increased, and poverty (measured by income, debt and assets) is exacerbated. Addressing financial exclusion is not merely about service provision; it also includes capacity building and structural change.*

People who experience financial exclusion understood in this sense have less agency in financial options, leaving them more likely to seek harmful lending sources that offer more complex financial products and more aggressively advertised services.[82] They are more susceptible to high-cost loans and lack the assets, savings, and financial safety nets for buffering emergencies.[83] Furthermore, a lack of accessible and safe credit options for non-traditional borrowers highlights the need for affordable, safe, and financially inclusive credit alternatives and services.

Figure 4: Buy-now-pay-later spending in 2019 and 2020



Source: Finder New Zealand Survey, January 2021

4.4 Buy-now-pay-later (BNPL) Schemes

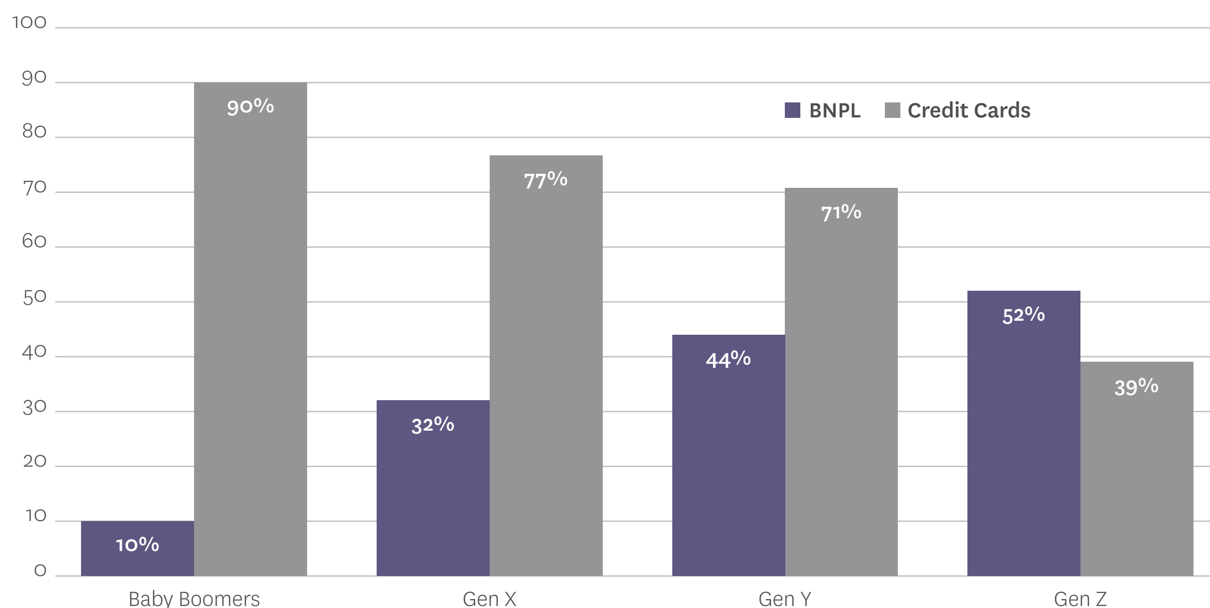
The latest credit phenomenon—buy-now-pay-later schemes—have gained immense popularity over recent years, particularly among younger generations. Unlike traditional loans and credit cards, BNPL is a modern-day version of the traditional lay-buy. People are provided with interest-free, short-term credit, often advertised as a healthier, simpler, and smarter alternative to credit cards. They can obtain up to $2000 in interest-free credit, where repayments plans are made over some time in 4-6 payment instalments.[84] Missed repayments incur late fees. BNPL companies operate on a model that offers short-term and readily-available credit whilst generating revenues from merchant fees and late fees.

There are six major schemes in the New Zealand BNPL market: Laybuy, Afterpay, Humm, Zip, Klarna, and Genoapay.[85] The BNPL market has seen steady growth since it was first introduced around 2018, but 2020 was when the industry exploded (See Figure 4). According to a BNPL Finder Survey, the number of customers grew by 49%, total spending more than doubled, and estimates highlight that BNPL accounts for 11% of all online shopping revenue.[86] Data from the New Zealand Post's e-commerce reports highlighted BNPL as a growing trend with a 49% increase in BNPL transactions in the first quarter of 2021 compared to the same period in 2020. Specific trends from available BNPL data highlight one in six Kiwis (17%) have BNPL debt, where two-thirds of individuals with BNPL debt are concerned about their debt levels.[87] Generation Z and Millennials[88] were the more common BNPL users, with women more likely to have used a BNPL service than men in the last three years (See Figure 5 below).[89]

In the absence of conclusive New Zealand evidence around the impacts of BNPL, insights and lessons can be drawn from international research from the UK and Australia, both of which have also seen a dramatic increase in the use of BNPL finance options.

In the United Kingdom, the Citizens Advice latest BNPL report estimated that in 2020 alone, 14 million people had used BNPL, many of whom incurred debt from missed payments and late fees and went without essentials to make BNPL payments.[91] The report warns of the potential detriment on borrowers should these consumer credit products remain unregulated. The easy access to interest-free credit is a slippery slope for encouraging unaffordable spending and is a pathway to problem debt. The potential long-term impacts include affected credit ratings and the normalisation of relying on credit for luxuries and basic living necessities.[92]

Figure 5: BNPL and credit card use by generation



Source: Finder New Zealand Survey, January 2021[90]

Evidence from Australia suggests that many BNPL consumers are cutting back or going without essentials to take out additional loans to make BNPL payments. The Australian Securities and Investments Commission (ASIC) found that 30 percent of the Australian adult population had used a BNPL service in the last fiscal year, where 21 percent of BNPL consumers missed a payment in the previous year.[93] In the 2018-2019 financial year alone, BNPL providers' revenue from late fees increased by 38 percent of the prior year totalling over $43 million.[94] Afterpay, an Australian BNPL company and one of the largest companies in the sector, reported $9.8 billion in underlying sales in the fiscal half ended Dec. 31, 2020, up 106 percent from $4.8 billion in the prior-year period. Afterpay users grew by 80 percent in the period from 7.3 million to 13.1 million.[95]

Currently, there is no direct regulation of BNPL schemes in New Zealand, it was noted by MBIE's 2018 review on consumer credit regulation that this was the case because there is insufficient evidence of serious harm to consumers.[96] It is likely that BNPL trends seen abroad will eventually appear in the New Zealand market. With increasing competition in the BNPL market, coupled with international evidence highlighting the invisible cost of BNPL and its financial impact on users, it is time to consider including BNPL regulation within the scope of consumer credit regulation or develop similar regulations to consumer credit products.

5. POLICY RECOMMENDATIONS

The relationship between lending and borrowing plays a crucial role in functioning economies and global and domestic financial markets. With the growth of credit-based economies, it is imperative for consumer credit laws and regulation to balance consumer protection while ensuring credit markets function as efficiently as possible. This includes cost-benefit considerations of regulatory measures and interventions against the harms of removing high-cost credit from the lending landscape.

It is necessary then to explore and invest in alternatives that balance regulation, promote financial education, and ensure consumer credit options are safe, ethical, and accessible to all borrowers. We acknowldge that recent credit law changes are proactive measures in addressing irresponsible lending practices. To support ongoing work towards curbing harmful lending, the following recommendations seek to provide practical solutions reflective of the realities of the consumer credit lending environment.

5.1 Increase investment in Microfinance credit with wrap-around support

The banking sector and the Government should scale up and optimise existing microfinance initiatives through increased investment. The banking sector could provide ongoing support through delivering loan capital and operational services such as accessibility to banking services.

Microfinance provides alternatives to high-cost credit helping people meet their financial needs while minimising risks of them falling into unmanageable debt. Borrowers are provided with financial support and credit with terms and conditions that are fair and affordable.[97]

In New Zealand, both the Nga Tangata Microfinance Trust and Good Shepherd New Zealand offer microfinance credit offerings using Kiwibank loan capital.[98] These loans vary in amount and purpose, however they generally help people purchase household items, second-hand vehicles, motor vehicle repairs, and also assist in paying off high-cost loans.[99] Loan applications factor in a borrower's financial and non-financial circumstances influencing their ability to service a loan and maintain other financial responsibilities. This person-centred focus moves beyond the limited transactional nature of consumer credit, from simply meeting financial needs to holistically incorporate its impact on all aspects of an individual's life.

Coupled with government investment, philanthropic investment in community and grassroots organisations should also consider an intermediaries model.[100] Community and not-for-profit organisations providing microfinance credit act as a bridge between lenders and borrowers. As well offering microfinance products intermediaries should deliver activities that work towards improving the credit worthiness of a borrower such as completing financial literacy courses, or a savings programme. Alongside raising a borrower's credit profile, wraparound support could be delivered through in-house social and health services such as counselling, family support, and justice-related services. Microfinance credit options offer an alternative to high-cost lending, particularly for low-income borrowers. The availability of low-interest or no interest loans coupled with holistic financial services offered through Microfinance enables people to shift from positions of financial exclusion.

5.2 Maintain increased government funding for core Building Financial Capability (BFC) services

The increased financial government support from government throughout the COVID-19 pandemic should be retained to resource services under the BFC sector that includes financial mentoring services, community organisations and iwi that deliver budgeting services and financial education. A mixed funding stream model enabling not-for-profit organisations to combine donors and philanthropic financial support with government funding, and if appropriate, industry support is optimal.

Annual government funding for core BFC services increased from $15.5 million to $22.12 million from 2020-2022. Whilst a temporary and time-limited increase, serious consideration is required around making this funding arrangement permanent. The financial impacts of COVID-19 on families, communities, and individuals with job losses, and insufficient incomes in view of rising living costs, calls for continued government funding of the BFC sector and services. Targeted government funding needs to focus on financial mentoring and

budgeting organisations offering a range of services from insolvency, debt solutions to financial literacy programmes, with particular focus on those offering wraparound services.

5.3 Include Buy-Now-Pay-Later in the scope of the Credit Contracts and Consumer Finance Act 2003 (CCCFA)

BNPL products and services should be subject to the same Responsible Lending Principles and legislative requirements in the CCCFA 2003 that are expected of all consumer credit providers. This includes being subject to similar or appropriate loan affordability checks and legislative regulations limiting the number of BNPL providers per user subject to income level.

Buy-now-pay-later services offer a credit product similar to a credit card but without the safety checks, yet they fall outside the consumer credit regulation scope. Largely unregulated internationally and here in New Zealand, the lack of consumer protections and loan approval requirements for BNPL use is alarming, leaving those who need it most without financial protection. Additionally, no legislative regulations limit the number of BNPL providers per consumer.

As the industry grows and new forms of lending emerge, the risk of consumer behaviour that leads to financial hardship and unmanageable debt levels increases. Regulating the sector becomes more vital and imperative, particularly for minimising the burden on consumers from tumbling down a rabbit-hole of debt. The Minister of Consumer Affairs and MBIE should review out of scope lending such as Buy-Now-Pay-Later schemes to be included under the CCCFA's regulatory scope. Regulation of the BNPL industry would mean increased consumer protection.

5.4 Develop a licensing framework for debt collection agencies and collectors

The Commerce Commission should develop a national licensing scheme for debt collection agents and agencies with lead oversight from the Commerce Commission, and working alongside dispute resolutions schemes.

Across most Australian states, for example, debt collection legislation provides the framework for license requirements, including eligibility criteria. Standard eligibility features for operating as a debt collector or debt purchaser include applicants being subject to a police check, passing a fit and proper person test, no convictions of prescribed offences, or suspension or disqualification from practicing an occupation, trade, or business under Australian law.[101]

Unlike lenders and financial services, debt collectors are exempt from licensing or requirements to register under a dispute resolution scheme. There is no centralised industry body for debt collection agencies, making it challenging to gauge the industry's size and the identities of debt collectors, alongside the ongoing regulation of poor debt collection practices. Whilst debt collectors are subject to legislative requirements and regulations under the CCCFA 2003, there are no licensing and compliance requirements for the debt collection industry. Establishing a licensing debt collection system enables monitoring the number of debts acquired by collection agencies and standardised debt collection practices across the industry. A national licensing scheme would encompass such activities that subsequently improve and enhance the monitoring of the debt collection industry.

5.5 Increase the regulatory functions of the Commerce Commission

Strengthen the regulation of consumer credit lending requires an expansion of the Commerce Commission's regulation responsibilities to include a regular or annual audit of all high-cost credit lenders. This provides the Commerce Commission with real-time industry data that can be useful for stakeholders in the lending industry and financial mentoring and debt solutions services sector. To maintain its enforcement functions whilst expanding its regulatory scope, the Commerce Commission would require additional funding. Funding streams can be a mixture of government support and industry funding through a compulsory annual lender levy. The administration of the lender levy including setting the levy would fall under the Commerce Commission's regulatory portfolio.

5.6 Develop a centralised database for high-cost loans

To support the function of new legislative regulations to the Responsible Lending Code, MBIE should develop and introduce a national database of high-cost, short-term loans.

New amendments to the Responsible Lending Code place greater responsibility on lenders to ensure consumer credit contracts or loans are affordable, and due diligence is carried out to uphold a borrower's rights. Introducing an interest cap and loan affordability assessment requirements as precautionary measures against financial hardship provide practical means for reducing irresponsible lending. To supplement these precautionary measures, a centralised database offers lenders more information on a borrower's history of high-cost loans, aiding the loan affordability assessment process and potentially minimising administrative costs for lenders. Its functions should include a red flag system for borrowers at risk of unmanageable debt. Here, the database doubles as a screening tool alerting the creditor of at-risk borrowers that need alternative credit options like microfinance and other support such as a budgeting service.

5.7 Maintain ongoing support for the National Strategy for Building Financial Capability (BFC) 2021-2024

We recommend ongoing government and finance industry support for nationwide solutions such as the National Strategy for Building Financial Capability (BFC) 2021-2024 led by Te Ara Ahunga Ora: Retirement Commission and its scope and approach towards addressing financial literacy and supporting the building financial capability sector.

As part of recent government initiatives to tackle financial well-being, the Strategy provides a framework that outlines a collaborative approach towards helping New Zealanders get ahead financially. It strengthens the Financial Capability sector through cooperative learning, sharing knowledge and best practices, and co-designing financial literacy initiatives and programmes. Consumer financial behaviour is complex and multifaceted, requiring multi-level solutions for building financial capability such as national strategies for financial education.

6. CONCLUSION

The interplay between lending and borrowing makes consumer credit an inevitable part of financial ecosystems. Growing aspects of the credit market that tend to be more harmful such as high-cost consumer credit lending requires policy decisions and market interventions to balance both the costs with the benefits. Consumer protection is essential alongside ensuring credit markets function efficiently. Healthy regulation is necessary for reducing harmful lending and its adverse effects on borrowers that depend on consumer credit.

Significant legislative amendments have taken pragmatic steps towards addressing consumer credit lending issues through more targeted lending provisions and a principles-based approach. Since the introduction of these provisions, New Zealand's consumer credit industry has, for the most part, complied with lending obligations.

However, Government reviews of consumer credit regulation have shed light on the ongoing issues that the regulatory changes and law reforms haven't solved. Some lenders continue to fail to comply, warranting concerns around irresponsible lending practices to poor debt collection practices. Newer consumer credits products such as Buy-now-pay-later services remain unregulated, despite growing international evidence of the potential for harm. Changes to consumer credit laws since the enactment of the CCCFA demonstrate that in the absence of fit-for-purpose statutes and regulations, conditions for harmful lending practices can leave the lending landscape a bit like the Wild West.

Legislative endeavors, however, do not operate in isolation from other factors that address irresponsible lending and the unintended impacts of high-cost loans, such as financial literacy and safer and accessible alternatives to high-cost credit like microfinance. The use of consumer credit is a choice for some users and an inevitability for others. It is important that all options for obtaining consumer credit, including alternatives, are accessible to all borrowers. Microfinance and financial education taken together could contribute towards building borrowers' resilience and empower them to make informed financial choices.

The policy recommendations we outline in this paper seek a responsible, fair, and more effective lending environment. We offer practical measures that bolster existing policies where they are succeeding, and regulatory mechanisms to increase consumer protection and reduce financial hardship where they are needed. Our recommendations include developing a licensing framework for debt collection agencies and collectors, investing in microfinance, preserving increased government funding for building financial capability services, and including buy-now-pay-layer schemes in the CCCFA's scope.

The spirit of the phrase, "teamwork makes the dream work," represents the collaborative approach required to address harmful lending and minimize the impacts of high-cost loans on borrowers. Government agencies, creditors, the finance industry, the building financial capability sector, debt solutions, and financial mentoring services are required to make this work.

For people like Casey (whom we met at the beginning of this paper), and for struggling families and communities disproportionately affected by irresponsible lending and high-cost loans, the dream is to be debt-free. For many high-cost credit borrowers, the dream is to live flourishing lives without debilitating debt and financial hardship. These dreams can become reality, but not without the teamwork. They demand healthy regulation coupled with multi-level solutions to harmful lending to create a consumer credit landscape that is fair, safe, and inclusive—bringing light to those in the shadow of debt.

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