



**Pacific Consumers' Behaviour and Experience in Credit
Markets, with Particular Reference to the 'Fringe Lending'
Market**

**Research Findings Report and Government's Response
Strategy**

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New Zealand Government

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Introduction

In 2006, the Ministry of Consumer Affairs asked the Centre for Pacific Studies at the University of Auckland to conduct qualitative research into Pacific consumers' behaviour and experience in the fringe lender market in South Auckland.

The research involved in-depth interviews with key people from community organisations based in South Auckland and focus group interviews with Pacific consumers. The researchers' report *Pacific Consumers' Behaviour and Experience in Credit Markets, with Particular Reference to the 'Fringe Lending' Market* is attached as Part C of this paper.

Part A of this paper sets out the wider context for the research and states the research objectives and the methodological approach taken. In particular, it places the research within the monitoring and evaluation framework of the Credit Contracts and Consumer Finance Act 2003 (CCCFA).

Part B contains a summary of the main research findings. It continues by outlining the government's initial response to the research, including what the Ministry of Consumer Affairs is proposing to do, and the implications of the research for the monitoring and evaluation of the CCCFA.

PART A: CONTEXT

Monitoring and evaluation of the Credit Contracts and Consumer Finance Act 2003

Reviewing legislation is part of the Ministry's routine work to ensure that consumer legislation is working well. These reviews take two forms

- *A review of the operation and implementation of the legislation*
These reviews are usually undertaken after about two to three years of actual operation of the legislation. Their aim is to ensure that the legislation is functioning as intended. It provides an opportunity to clarify legislative intent or rectify legislative design issues which have only become apparent after implementation and which may be hampering the effectiveness of the legislation.
- *A full review of the legislation including the underlying philosophy of the Act*
These reviews are usually undertaken after at least five years actual operation of the legislation.

The CCCFA came into force from 1 April 2005. A review of the operation and implementation of the CCCFA will be completed by 31 March 2008. Following this, a report will be forwarded to the Minister of Consumer Affairs. The Report will recommend possible areas where the legislation may need to be amended to improve its effectiveness.

The research contained in Part C of this report forms part of the process of monitoring and evaluation that will inform the CCCFA Operation and Implementation Review. The Ministry of Consumer Affairs' consumer issues management process is the primary source of evidence for monitoring the practices of credit providers and the experiences of consumers in credit markets.

The consumer issues management process includes gathering information from organisations such as the Financial Services Federation, New Zealand Federation of Family Budgeting Services, National Association of Citizen's Advice Bureaux and community law centres. Where the need for further information is identified, discrete research exercises such as that into Pacific consumer behaviour and experiences in credit markets, are undertaken.

Information from the Commerce Commission on matters relating to enforcement is also part of the CCCFA monitoring framework.

The monitoring framework is based on the policy objectives of the CCCFA, and aims to:

- identify the specific issues associated with each purpose, and how these issues have been addressed in the CCCFA
- understand how the CCCFA influences the behaviour of credit providers and consumers, and
- identify any issues relating to enforcement of the CCCFA which affect the achievement of the stated purpose.

The monitoring framework is designed to be flexible. This allows for emerging issues in credit markets to be prioritised and followed up with more in-depth information, such as market research and legal casework analysis.

Objectives of consumer credit law

The CCCFA is the principal legislation that governs credit provision. All lenders are bound by this Act. The policy objectives underpinning the CCCFA are to:

- promote efficient credit markets that are conducive to voluntary transactions
- require effective information disclosure, so that
 - consumers can distinguish between different credit products and, as far as possible, make rational choices between those products and cash purchases
 - consumers are adequately protected from deception
- allow for innovation in the design of credit products
- provide adequate incentives for compliance with the law by all parties to a credit transaction
- discourage oppressive conduct by lenders.

Through the information gathered during monitoring, the Ministry will be able to assess whether the policy objectives of the CCCFA are being met. If it is found that consumers are suffering loss because the objectives of the Act are not being met, the Ministry will work towards implementing or recommending appropriate interventions.

An intervention could be a policy recommendation or it could be an informational programme. The aim of any intervention would be to change the behaviour of traders or consumers. For example, if the problem occurs because consumers do not understand their rights under the CCCFA, then a targeted informational campaign may be recommended. Alternatively, if the problem is due to the CCCFA provisions being unclear or vague, an amendment to the Act may be recommended.

Gathering information about credit markets

Through its evidence gathering, the Ministry has identified the fringe lending market as one in which consumers are more likely to suffer detriment in the form of harsh and oppressive credit contracts, high interest rates, fees and penalty charges, and a resulting high level of indebtedness. From its consumer enquiries database, the Ministry also identified that within the fringe lending market, low income, non-English speaking consumers are more vulnerable, and that Pacific Island consumers are over-represented among those who suffer detriment as a result of fringe lending practices.

In order to gather more detailed information about the fringe lending market, the Ministry commissioned desk research¹ in 2006 to look at the regional distribution of fringe lending businesses. The research revealed that fringe lenders appear to be concentrated in lower income communities, particularly in South Auckland. Of the 71 fringe lenders located in Auckland, 23% have a branch in or around Manukau City, 14% have an office in Otahuhu, 14% in the North Shore and 8% in West Auckland. Fringe lenders may be defined as sharing some of the following characteristics²:

- small, often owner-operated, specialising in personal cash loans
- higher interest rates than mainstream lenders
- large administration fees out of proportion to the size of the loan (may include establishment, security inspection, documentation and loan shortfall insurance policy fees)
- loans may be secured against personal property (e.g. cars, houses, household appliances)
- item for security often worth considerably more than the loan (e.g. car, house)
- loan amounts are often small and repayment short term (sometimes even next pay day)
- provide immediate availability of cash

¹ See Research New Zealand, *Fringe lenders in New Zealand*, July 2006.

² See Research New Zealand, *Fringe lenders in New Zealand*, p.14.

- may offer pawnbroker services
- may deal with defaulters through strategies such as ‘naming and shaming’ (e.g. in community newspapers)
- holding ATM cards, garnishing benefit payments, etc., targeted at specific communities (particularly ethnic communities, beneficiaries, low income neighbourhoods and those with poor credit ratings)
- possibly less flexible terms and conditions, few credit checks and little paperwork to fill out; and
- may provide limited documentation or overly simplified contracts (which is often promoted in their advertisements).

The Ministry of Consumer Affairs operates a dedicated free phone for Pacific consumers. Anecdotal data from this source suggests that in some cases Pacific consumers are getting into financial difficulties through what would appear to be oppressive and otherwise unlawful conduct by fringe credit providers.³

It was in this context that the Ministry commissioned the research on Pacific consumers’ behaviour and experience in fringe lending credit markets. The research was based in South Auckland where there is a large Pacific population and where fringe lenders are particularly prevalent.

Pacific consumers in credit markets research

Background

It would appear that providing credit to Pacific consumers is a distinct submarket within the overall credit market. There is evidence that Pacific consumers are targeted by fringe lenders through advertising and other marketing practices. One marketing technique is to play on the socio-cultural obligations, faalavelave, of Pacific consumers and their need to have access to finance on short notice to meet these obligations.

Research objectives

Within the context of monitoring the CCCFA, the Ministry’s research objectives were to explore the behaviours and experiences of Pacific consumers in relation to obtaining consumer credit in the New Zealand fringe lending market.

Specifically, trader practices as experienced by consumers that were identified for investigation were:

- current disclosure practices
- availability and accessibility of lending institutions in the area

³ Such cases are referred to the Commerce Commission which is responsible for the enforcement of the CCCFA.

- typical brokerage and fee schemes - in the context of the legislative requirement of 'reasonable'
- oppressive contracts and credit provider conduct
- influence of finance marketing – advertising to, and targeting of, Pacific consumers; and
- lending practices in relation to motor vehicles.

The study of consumer behaviour/knowledge was also an important research objective. In particular, the research canvassed:

- frequency of 'shopping around' in credit markets
- what type of demand necessitates the need to borrow, e.g. church and family obligations
- knowledge and recall of recourse and redress methods/attempts
- consumer understanding of responsibilities and obligations
- saving money vs. the cost of credit
- level of consumer concern in relation to defaulting and credit ratings; and
- consumer debt and the consequences of bad credit deals.

Research Methodology

The research was qualitative⁴ in nature and involved

- Twelve semi-structured face-to-face interviews with key informants from nine agencies providing assistance to Pacific consumers in South Auckland.
- Ten focus group interviews, each lasting two to three hours involving Pacific consumers. Both men and women were interviewed and these included a range of ages, household income levels, and educational qualifications.
- Fifty individual face-to-face interviews, each between one and a half and two hours, with Pacific consumers were conducted (although some were interviewed with their partners).

Caveat on usage of the data

The qualitative nature of the research means that it provides a snapshot of the South Auckland fringe credit market as experienced by those Pacific consumers and

⁴ Qualitative research provides an understanding of how or why things are as they are. Unlike quantitative research, there are no fixed set of questions but, instead, a topic guide is used to explore various issues in-depth. The discussion between the interviewer and the respondent is largely determined by the respondents' own thoughts and experiences.

community organisations interviewed. Further research would be needed to establish whether the experiences of Pacific consumers extend themselves to other geographical locations and other communities within New Zealand.

PART B: SUMMARY OF FINDINGS AND GOVERNMENT RESPONSE STRATEGY

Summary of findings

The research identified that Pacific consumers reported borrowing to meet the needs of everyday household expenses as the most common reason for using the services of fringe lenders. Purchasing large items, especially cars, was the second most common reason for borrowing. Potentially exploitative lender practice particularly with respect to car loans was noted in the research.

Meeting social and cultural obligations was mentioned as the third most common reason for borrowing and, like the first, is an area often requiring access to 'instant cash'. These social and cultural obligations are usually for events for which people cannot easily plan, so increasing their potential susceptibility to unreasonable and oppressive credit provider practices.

The research reported positive stories about how Pacific people manage their finances across these three areas, including that most loans are repaid. However, the overall picture is that Pacific consumers' need for easily accessed cash loans and inability to access cheaper credit options, leaves them exposed to high cost credit and the possibility of oppressive credit contracts.

The researchers concluded that experiences and perceptions expressed by the interviewees challenged the notion that, if certain information is available (through improved disclosure), consumers will use it to make the decisions that will shape the development of a competitive credit market. Even those Pacific consumers with reasonably high levels of financial literacy and awareness of the high costs involved in the fringe credit market felt they had limited choice about the conditions under which they accepted the credit they sought.

The research report also suggested that the ways in which information is provided (small print, technical language, etc.), and by whom, can prevent the consumer arriving at the understanding needed to make an informed decision.

The research noted that Pacific consumers expressed a fear that questioning or complaining about the credit contract would prevent them from being able to borrow at all. Furthermore, seemingly important questions appear not to be asked by Pacific consumers because of the trust placed in the credit provider, especially when the credit provider is a member of the same ethnic community. According to the report, there is evidence that the CCCFA does not sufficiently protect credit consumers dependent on fringe lenders. Stronger enforcement of the Act by the Commerce Commission was seen as necessary by the community organisations interviewed.

Among respondents there was a low awareness of the CCCFA combined with a low awareness about avenues for redress. The need for more, better and earlier consumer

education is strongly indicated as is the need for Pacific community leaders to work closely with the various community and legal agencies in developing and publicising Pacific-friendly information.

For the majority with lower levels of financial literacy, concern about getting the money was more important than the terms of the credit contract. The vital information for Pacific consumers appeared to be the size of the weekly repayment rather than the total cost of a loan.

Government response

The research provides rich insights into Pacific consumers' behaviour and experiences in the South Auckland credit market and their perceptions of government's role and the legal rights and responsibilities of consumers and traders.

It should be said from the outset that many of the issues identified by the research are complex, requiring a response at government, business and community levels. These issues will also require a concerted effort over time.

From the research, the following work priorities for government have been identified

- continued enforcement effort where traders are not complying with the law
- providing a means by which consumers can work their way out of debt
- an information and capability building programme to address consumers' lack of access to information about their rights in a transaction or how to get redress
- addressing overly-aggressive marketing practices
- engaging at the government, community and business level to develop potential solutions to the problems
- completing the review of the CCCFA.

The work programme draws on preliminary discussions with the Ministry of Social Development, the Ministry of Pacific Island Affairs and the Commerce Commission and is in keeping with relevant work being undertaken by these agencies. Several initiatives, described next, require a cross agency approach and are being led by other agencies. Where this is the case, the work programme outlines the Ministry of Consumer Affairs' participation in the initiative.

The table below summarises the key issues and the responses:

<i>Issue</i>	<i>Response</i>
Non-compliance with current legislation	<ul style="list-style-type: none"> • Enforcement by Commerce Commission • Possible incorporation of the Credit (Repossession) Act into CCCFA • Improved access to redress • Registration of credit providers
Helping consumers to work their way out of debt	<ul style="list-style-type: none"> • New Insolvency provisions
Information needs	<ul style="list-style-type: none"> • Building the capability of key agencies to address their clients' consumer credit issues. <ul style="list-style-type: none"> ○ Training needs assessment. • Pilot consumer clinics • Targeted information for consumers at risk <ul style="list-style-type: none"> ○ The TrueCost' pilot campaign
Marketing practices	<ul style="list-style-type: none"> • Review of Code of Financial Advertising
Need for wider engagement and ownership of issues and solutions	<ul style="list-style-type: none"> • Consumer Credit Summit • Social responsibility in lending
Ensuring effectiveness of CCCFA	<ul style="list-style-type: none"> • Complete review of CCCFA <ul style="list-style-type: none"> ○ Further quantitative research ○ Disclosure provisions ○ Discussion on Interest rate caps

1. Non-compliance with current legislation

The research provides additional evidence of conduct by credit providers which appears to be in breach of the law and is causing serious detriment to Pacific consumers. Areas of apparent non-compliance include what appear to be breaches of:

- the Credit Contracts and Consumer Finance Act 2003 – oppressive conduct and contracts, unreasonable credit fees, in particular default fees, and inappropriate credit related insurance
 - the Second-hand Dealers and Pawnbrokers Act 2004 – illegal 'buyback of goods' contracts
- the Fair Trading Act 1986 – misleading and deceptive conduct, and false and misleading representations

- Consumer Guarantees Act 1993 – creditors’ failure to accept that they are responsible for the representations of car dealers and brokers, and failing to accept that they are suppliers under the Act and therefore directly liable for any breaches of the guarantees
- Credit (Repossession) Act 1997 - creditors continuing to add penalty interest and other fees to the amount owing after they have repossessed and sold a consumer’s car.

Similar examples emerge from other research studies and other work carried out by the Ministry of Social Development, the Ministry of Pacific Island Affairs, the Commerce Commission, and Insolvency officers in the Insolvency and Trustee Service of the Ministry of Economic Development.⁵ The common thread is that the behaviour of non-complying creditors could be argued to amount to oppression.⁶

Improved Enforcement of the CCCFA, Fair Trading Act and Consumer Guarantees Act

The Commerce Commission is responsible for the enforcement of the CCCFA. One difficulty it has had with enforcement is that the number of complaints received about credit issues has been considerably lower than anticipated. To address this problem the Commerce Commission is undertaking several initiatives including strengthening relationships with community groups (particularly in South Auckland) and undertaking proactive compliance inspections of credit providers. As a result of its proactive approach, the Commerce Commission has recently completed a number of successful investigations.

The Ministry of Consumer Affairs’ research reflects the Commerce Commission’s understanding that South Auckland is an area of particular non-compliance. The Commerce Commission has taken a number of enforcement actions to date against South Auckland based traders targeting ‘vulnerable’ consumers. More enforcement actions in South Auckland are due to be completed within the next few months.

The Commerce Commission is looking in particular to take some cases that will enable them to establish a precedent around the reasonableness of establishment and default fees and other fees charged by credit providers.

In addition to investigating apparent breaches of the CCCFA, the Commerce Commission is also able to simultaneously assess for breaches of the Fair Trading Act. In respect of the Second-hand Dealers and Pawnbrokers Act, false representations that second hand dealers and pawnbrokers have the right to hold goods will probably amount to a breach of the Fair Trading Act.

As breaches of the Consumer Guarantees Act are often also breaches of the Fair Trading Act, the Commerce Commission is also able to assess for non-compliance in this area.

⁵ The studies being referred to cover wider than South Auckland and Pacific consumers and also suggest the issues are not confined to the fringe lender end of the consumer credit industry.

⁶ Oppression is a term used and defined in the CCCFA to cover situations where a creditor’s conduct or the provisions of a credit contract are harsh, oppressive, unjustly burdensome or unconscionable. The CCCFA allows a court or a disputes tribunal to reopen and vary a credit contract where it is found to be oppressive.

Enforcement of the Credit (Repossession) Act 1997

As already mentioned, the research has pointed to apparent non-compliance with the Credit (Repossession) Act. One of the difficulties for consumers is that there is no agency (like the Commerce Commission) responsible for monitoring and enforcing compliance with the Credit (Repossession) Act. It is extremely hard for consumers to take a personal action for breach of this law. One option the Ministry of Consumer Affairs is considering is whether matters covered by the Credit (Repossession) Act should be included in the CCCFA. Under this scenario, the Commerce Commission would have a role to monitor and enforce compliance with credit repossession requirements alongside other CCCFA matters.

Improved Access to Redress

Where consumers have effective access to dispute resolution and redress, credit providers have an additional incentive to comply with the law. An issue illustrated in the research is that access to redress is often difficult for consumers in dispute with credit providers. Many credit contracts, especially those for the purchase of a motor vehicle, involve amounts that exceed the jurisdiction of the Disputes Tribunal. District Court action, including defending a judgement debt application brought by a creditor, is too expensive for most consumer debtors.

Credit provider registration linked with improved consumer dispute resolution

As part of decisions taken following the Ministry of Economic Development's review of financial products and providers, Government recently announced that controlling shareholders, directors and senior management of entities providing non-banking financial services will be required to be registered and to meet 'negative assurance criteria'. The registration system will give some assurance about the integrity of people running financial institutions including credit providers.

The registration database will be publicly accessible. This means that consumers will be able to search the register of credit providers and obtain information on their integrity and the capability of the people running the lending operations.

As part of the licensing requirement all financial providers, including fringe credit providers, will have to belong to a consumer dispute resolution scheme. This will provide consumers with low cost access to an effective consumer dispute resolution forum where they can address concerns about unfair or inappropriate treatment.

An effective, fair, independent and transparent financial sector dispute resolution scheme will provide improved access to redress for consumers. The Ministry of Consumer Affairs is providing policy input into the development of the registration system and the consumer dispute resolution scheme and will seek to ensure that both are easily accessible.

2. Helping consumers work their way out of debt

As the research shows, an ongoing need to use credit means that some people will fall into debt for loans that they are unable to repay. The reform of the Insolvency Act, which is expected to come into force in December 2007, provides for two procedures which will make ways out of the 'debt trap' available for some consumer debtors.

Procedure One: Reform of the Summary Instalment Order Process – a Summary Instalment Order (SIO) is a court order, made by a District Court Judge, which allows people to repay their debt in regular instalments over a period of up to three years. Creditors are barred from taking court action to collect debts while an SIO is in force in relation to those debts. When an SIO is made, a supervisor is appointed to help the debtor manage their payments. Budget advisors often act as supervisors.

The reform extends the existing SIO regime. The total debt threshold will rise from \$12,000 to \$40,000, and the Official Assignee in the Ministry of Economic Development's Insolvency and Trustee Service will have responsibility for overseeing this regime. The Official Assignee also has the discretion to extend the term of the order from 3 to 5 years. An SIO will be granted when a debtor is unable to immediately repay those debts but can pay some or all of them over time. The reforms will make the SIO option much more accessible to debtors. It may also be a point at which information and education can be provided about debtor's rights under consumer law, and a point at which breaches of the law can be spotted and referred on to appropriate agencies.

Procedure Two: The No Asset Procedure – the reforms will also introduce a 'No Asset Procedure' (NAP) as an alternative to bankruptcy. This is aimed at consumer debtors who have run up debts. It provides a one off chance for a consumer debtor to make a fresh start. The NAP will last 12 months instead of the normal 3 year term for bankruptcy. A debtor would be eligible to enter into a NAP if they:

- have no realisable assets, and
- have not previously been admitted to the NAP, and
- have not been adjudicated bankrupt before, and
- have debts of between \$1,000 and \$40,000, and
- have no means of repaying any amount of the debt under a prescribed means test.

Consumer debtors will be able to access the NAP as for a bankruptcy, either by voluntarily filing a Debtors Petition for bankruptcy at the High Court, or after a creditor has applied to the High Court. In either case, the Court will appoint an Official Assignee, and an Insolvency Officer from the Insolvency and Trustee Service will be assigned shortly after adjudication to administer the NAP on behalf of the Official Assignee. The Official Assignee retains overall discretion to allow a debtor entry into the No Asset Procedure.

These changes are due for implementation in December 2007. There is information on the reforms on the Insolvency and Trustee Service (ITS) website (www.insolvency.govt.nz). ITS is also currently undertaking targeted education around New Zealand. A revised leaflet for consumers on personal bankruptcy will be available. ITS will provide information to budget advisors and are planning training for budget advisors and WINZ case managers, possibly in tandem with the Ministry of Consumer Affairs and the Ministry of Social Development. ITS is also active in informing business, particularly the credit industry of the reforms.

3. Information Needs

Several initiatives, described below, draw on preliminary discussions with the Ministry of Social Development, the Ministry of Pacific Island Affairs and the Commerce Commission and are in keeping with relevant work being undertaken by these agencies.

The Ministry of Consumer Affairs has discussed its work programme, as it relates to broader issues such as financial literacy and over-indebtedness, with the Ministry of Social Development. The objective is to identify where the Ministry of Consumer Affairs can add value to the Ministry of Social Development's programmes.

The Ministry of Consumer Affairs will focus on spreading knowledge of consumer credit law, through initiatives that include the design and delivery of informational campaigns and continuing to develop effective relationships with community agencies.

Building the capability of key government and community agencies to understand and use the CCCFA to assist their clients

In circumstances of consumer debt and credit contract issues, consumers (and as the research shows, especially Pacific consumers) are reluctant to take action, seek help, or go looking for information until their issue has reached a crisis point. At this point, the research indicates, consumers in debt to fringe lenders will frequently seek help from community organisations such as budget advisory services, or are likely to come to the attention of Work and Income and the Insolvency and Trustee Service.

Information is most effective when it is provided at the time it is needed and in the place where guidance or help is being sought. In this case, the best time and place to inform consumers about their rights and their options for redress is when they are taking action over a problem, and at the place where they go for assistance. The Ministry of Consumer Affairs is particularly interested in working with Work and Income to explore how their clients can have non-complying loans and debt demands properly identified and assessed.

The research shows that these agencies would benefit from in-depth training and capability building on the CCCFA so that they are better placed to identify any legal issues with financial contracts, how to make effective use of the hardship provisions of the Act on behalf of their clients, and how to obtain redress for their clients. Frequently, their staff are addressing emergency situations such as imminent repossession of goods, where the priority is to try to negotiate a payment arrangement with the creditor, rather than spend time looking for breaches of the law.

The Ministry currently provides training in consumer law for community organisations that deal with consumer credit problems, such as Citizens Advice Bureaux, budget advisory services and community law centres. In consultation with these and other community organisations the Ministry will extend this capability building activity.

Training needs assessment – the first step

As a first step, following the presentation and release of this work programme and the research findings to South Auckland community organisations, especially the key informants in the research, South Auckland community agencies will be invited to participate in needs assessment workshops to establish what their organisation needs to better assist their clients. A further similar needs assessment activity for community agencies nationally will enable the Ministry to put together an on-going capability plan for the future.

Officials from the Ministry of Consumer Affairs and the Ministry of Social Development have met to discuss capability issues among WINZ case managers and frontline staff in relation to their work on over-indebtedness. In comparing the Ministry of Social Development's research on fringe lending and other sources of client debt, (particularly their research on the level of debt among beneficiaries), with the Ministry of Consumer Affairs' research, both agencies have been able to develop a richer and better informed picture of the issues needing to be addressed.

Among other concerns, there is evidence that Work and Income grants and benefits are possibly inadvertently being approved to pay debts that may arise from unenforceable contracts or contracts that contain amounts which have been charged in breach of the law. The research highlights a perception that fringe lenders will lend to beneficiaries because they know that if the debtor cannot repay the loan, the government will.

Ministry officials have also met with Ministry of Pacific Island Affairs' officials to discuss opportunities for developing training modules on credit law and working together on information campaigns, to support the Ministry of Pacific Island Affairs' financial literacy initiatives.

Piloting Consumer Clinics

The Ministry of Consumer Affairs will be working with the Otago Community Law Centre to pilot a fortnightly consumer clinic at their premises. This will enable the Ministry to assist law centre clients, and to gather additional information about consumer issues particularly involving credit and debt. This small scale, tightly focussed, project will be evaluated to look at the possibility of extending it.

Targeted Information

The issues identified in the research are that current disclosure arrangements under the CCCFA, while simpler than earlier legislation, may still be too complex and technical for consumers making a decision to enter into credit contracts. In addition, the key disclosure information is accompanied by a very long, complex, and legalistic credit contract which many consumers could not understand, even if they did try to read it. Some of the research participants have called for plain English contracts and simplified disclosure.

More information about the CCCFA and its enforcement is needed by community groups, traders and consumers, particularly in the biggest area of detriment which involves the purchase of motor vehicles on credit. In particular, a major area of concern is that consumers are reluctant to ask relevant questions of motor vehicle traders.

The TrueCost Checklist public awareness campaign response

The Ministry of Consumer Affairs runs separate public awareness-raising campaigns every year on the CCCFA and the Motor Vehicle Sales Act (MVSA). This year's campaign will combine the two activities. The aim is to reach the South Auckland car buying audience, particularly Pacific consumers, and to address the reluctance of some consumers to ask relevant questions when borrowing money to buy a car.

This multi-media campaign pilots a new approach and commenced in the second week of August 2007. The campaign is aimed at Pacific consumers and South Auckland community agencies and encourages consumers to ask questions about credit deals associated with buying a car. The media campaign includes a 'TrueCost' checklist mailer being provided to all South Auckland households. The mailer contains important information about purchasing cars using credit. This campaign has been developed with input from the Ministry of Consumer Affairs' Pacific Island Reference Group in South Auckland. The TrueCost checklist and some of the key information is being provided in English, Samoan and Tongan.

The Ministry of Pacific Island Affairs supports the campaign and the Ministry of Social Development has been informed, with the TrueCost checklist and information being sent to Auckland Work and Income offices.

The pilot campaign will be evaluated to determine whether to extend the campaign to a wider audience.

The effectiveness of the disclosure requirements of the CCCFA including when and how this disclosure takes place is a key part of the review of the operation and implementation of the CCCFA. The TrueCost checklist campaign will help inform the Review by testing a simplified form of disclosure accompanied by advice on how to make a good credit decision. For more information, visit www.truecost.govt.nz.

4. Marketing Practices

The research describes a high level of concern among Pacific consumers and community groups about the way in which fringe lenders market their services. Research participants describe extensive advertising targeting welfare beneficiaries and those with bad credit ratings (including those who are bankrupt) and direct appeals to consumers on the street and in shopping malls. Research participants were concerned that the extent and methods of this marketing were resulting in more consumers making bad credit decisions.

Earlier desk research into the geographical distribution of fringe lenders in New Zealand⁷, commissioned by the Ministry of Consumer Affairs, identified that the advertisements of fringe lenders often use a number of hooks to encourage people to

⁷ See footnote 2

use their services. For example, by emphasising the effortless and speed of applying for and getting a loan.

The Advertising Standards Authority (ASA) administers a Code for Financial Advertising. This Code provides that financial advertisements '*should observe a high standard of social responsibility particularly as consumers often rely on such services for their financial security*'.

Credit advertising and marketing are important and legitimate ways for credit providers to reach their customers and enhance competition and innovation in the credit market. Nevertheless, some credit advertising and marketing may promote consumer over-indebtedness or poor product choice.

The Ministry of Consumer Affairs has asked the ASA to consider the implications of the research for their Code, with a view to including guidelines relating to the particular effects on vulnerable consumers of advertising credit products as an easy solution to problems of over-indebtedness.

5. Engaging with Community and Business groups regarding financial issues and vulnerable consumers

In the context of more consumers getting into a debt spiral combined with reported low levels of financial literacy, the Government is giving a high priority to providing a forum to discuss the issues consumers of credit providers are facing and to canvass solutions for addressing these issues. The information gained from this forum will also provide insights about the operational effectiveness of the CCCFA to inform the Review of the Act.

Consumer Credit Summit

The Minister of Consumer Affairs intends to convene a summit of individuals and groups with an interest in financial issues and consumers later in 2007. The purpose of the summit would be to bring the wide range of interested business, voluntary sector and community groups, and government agencies together to talk about how current credit law, lending practices, financial education and community and business partnerships operate and new ideas for enhancing this suite of practices/initiatives.

The summit concept is modelled on a recent successful round table in Australia, where a range of parties discussed credit issues. Such a forum has the advantage of having a wide cross section of groups allowing business, voluntary and community groups to hear each others' concerns and to have free and frank discussions about solutions to the issues raised.

Social Responsibility in Lending

Two of the areas for exploration at the summit will be the concept of socially responsible lending and the provision of low cost loan products including possible avenues for small amount lending. The concept of socially responsible lending is being given increasing emphasis, world-wide. In Australia, some banks have recognised the importance of committing to corporate social responsibility. For example, in late 2005 the ANZ published its Corporate Responsibility Report 2005 detailing among other

things the benefits of its financial inclusion initiatives for disadvantaged consumers (ANZ Bank, 2005). In New Zealand, Westpac has established a Community Consultative Council with the purpose of understanding the bank's impact and responsibilities within the New Zealand community.

6. Ensuring the effectiveness of the CCCFA

Review of the CCCFA

As already mentioned, information gathered during the monitoring of the CCCFA will enable the Ministry to assess whether the policy objectives of the CCCFA are being met. Part of this Review will be to establish whether further interventions are required.

Further research to measure consumer detriment

The Ministry of Consumer Affairs proposes to conduct quantitative⁸ research to measure consumer detriment in fringe credit markets as part of its CCCFA monitoring regime. This will build on the qualitative research study conducted in South Auckland in order to discover whether the South Auckland issues are also found nationally. This research would further inform informational and capability building initiatives similar to those discussed in this paper.

Disclosure

The Ministry of Consumer Affairs has identified that in some credit markets the disclosure provisions of the CCCFA do not appear to be effective in allowing consumers to distinguish between different credit products or to make rational choices between credit products and cash purchases.

When the Ministry reports back on the operation of the CCCFA in March 2008 it will be recommending changes to the disclosure provisions. As already mentioned, a pilot, the TrueCost checklist campaign will help inform these recommendations by testing a simplified form of disclosure accompanied by advice on how to make a good credit decision.

Interest Rate Caps

One suggestion raised in the research to deal with the issues faced by users of fringe lenders in their community was for the government to regulate to set a maximum interest rate (interest rate cap).

This suggestion stems from the concern that fringe lenders charge very high effective interest rates for short term borrowing. The concept behind having a capped interest rate for loans is to achieve a reduction in the total cost of the finance. The perceived

⁸ Quantitative research incorporates the statistical element (e.g. how many?), designed to quantify the extent to which a target group are aware of, think this, believe that or are inclined to behave in a certain way. For reliable conclusions to be drawn from the research, samples for quantitative research must be representative of the target group.

benefit is that it stops lenders from being extortionate, i.e. setting their own very high rate to gain excess profits off vulnerable people.

An assessment of countries with capped rates show there is much variation in the level that is set. In Australia, for example, New South Wales, Victoria and ACT have a 48% interest rate cap. Ireland has a 200% cap. Germany has a 20% cap and Japan an 18% interest rate cap. Overseas experience shows that lenders respond to a capped rate in two ways.

- A rate set low may reduce the willingness of a lender to lend money if they consider the risk of default on the loan is higher than the rate of return.
- A rate set high will encourage lenders to gouge the market by increasing their lending rates to the maximum rate. If all lenders follow suit then consumers will pay more for their loans than they would have under a typical free market system.

With respect to lending options, Ireland, with an interest rate cap of 200 percent compared to the United Kingdom which has no limit, has a smaller range of short term loan options than the United Kingdom. The Irish ceiling appears to have excluded low-income consumers from the market or may have led consumers to use products that are unsuitable for their needs.

The Australian experience suggests that if an interest rate is set too low, reducing the profit margin of a lender, the lender responds by increasing their fees. In effect this increases the total cost of the loan, possibly even negating the effect of the cap. An 'emergency' amendment to the Australian Uniform Credit Code is currently being pursued to close this particular loop-hole.

Payday lenders and fringe credit lenders play an important role in lending for unforeseen financial difficulty such as a funeral expense or illness (or lending to consumers who have difficulty in borrowing from mainstream banking institutions). There is a concern that capping interest rates would encourage such lenders to go underground. This would mean the protections of the CCCFA would not be available to those accessing finance from such sources. To allow these lenders to operate and meet this kind of consumer need, the interest rate would need to be capped at a very high rate, somewhat defeating the intention behind capping in the first place.

Another concern is that a capped interest rate set by the government could possibly give consumers a false sense of security. A consumer may believe the rate has been set at a level which the government has determined is within a range that is 'safe' for the consumer to enter into. This will not always be the case given the variability of conditions and circumstances in which people find themselves.

On the basis of overseas experience, the Ministry of Consumer Affairs does not consider that interest rate caps should be pursued. The Ministry will, however, continue to monitor international practice on capped interest rates and other mechanisms to improve credit practices.

Part C: Pacific Consumers' Behaviour and Experience in Credit Markets with Particular Reference to the 'Fringe Lender' Market – Final Report