



## Credit Contracts and Financial Services Law Reform Bill Commerce Committee

### The Salvation Army (New Zealand, Fiji and Tonga Territory) Submission

#### 1. BACKGROUND

- 1.1. The Salvation Army is an international Christian and social services organisation that has worked in New Zealand for one hundred and thirty years. The Army provides a wide-range of practical social, community and faith-based services, particularly for those who are suffering, facing injustice or who have been forgotten and marginalised by mainstream society.
- 1.2. We have over 90 community ministry centres and churches (corps) across the nation, serving local families and communities. We are passionately committed to our communities as we aim to fulfil our mission of caring for people, transforming lives and reforming society, by God's power.
- 1.3. An important component of the services that we offer is our budgeting programme. Budgeting services are offered all over the country to provide help to the many individuals and families who come to us and cannot afford to pay for basic items and are in difficult financial circumstances. Our staff work alongside those in desperate need with advice to help them get out and stay out of debt, and liaise with debtors on their behalf. The Salvation Army therefore directly sees every day the contributing and causative factors and effects of problem debt and financial hardship.
- 1.4. This submission has been prepared by the Social Policy and Parliamentary Unit (SPPU) of The Salvation Army. This Unit works towards the eradication of poverty by encouraging policies and practices that strengthen the social framework of New Zealand. But it has been greatly informed with feedback gained from budgeters, social workers and key social services management staff working at our Community Ministry centres. We acknowledge their feedback and tireless work.
- 1.5. This submission has been approved by Commissioner Donald Bell, the Territorial Commander of The Salvation Army's New Zealand, Fiji and Tonga Territory.

#### 2. THE SALVATION ARMY PERSPECTIVE

- 2.1. We believe that the harm caused by problem debt and unregulated consumer credit on families and communities already facing hardship is significant. The regulation of this industry is long overdue and we welcome the introduction of this legislation.

Therefore we **generally support this Bill.**

2.2. However, our contention is also that this Bill does not go far enough in regulating this industry. We urge the Government to take this opportunity to put in place greater protection for those who are most vulnerable and trapped in problem debt.

### 2.3. The usury of unreasonable interest

2.3.1. We submit that for “consumer protection” to be truly elevated as the primary purpose of the Bill as stated in its Explanatory note, unregulated interest levels must be addressed and capped. Whilst the Bill has the vital goal to lessen the extent to which lenders can exploit vulnerable families and addresses this through a variety of important measures, the legislation still does not specifically address a key issue of the level of interest rates that lenders are able to set.

2.3.2. At its most basic level, the reasoning behind lending with interest rates is to allocate and “pay” for the risk taken on by the lender when loaning credit to a borrower. The concept of usury acknowledges that this balance is prone to imbalance when unreasonable rates are charged that are no longer a question of burden of risk to the lender. Exorbitant rates instead become an instrument of manipulation and control. The fact that the vast majority of these loans are repaid indicates that the high risk that is assigned to low-income people is not justified.<sup>1</sup> For true responsible lending to be implemented, the scales need to be re-balanced and regulated.

### 2.4. Usurious interest rates: a moral and ethical issue

2.4.1. The Salvation Army is a Christian organisation which is informed by the principles in the Bible that warn against usury being done for unjust gain. A lender should not take advantage of the uninformed, the disadvantaged, or the coerced to charge excessive rates of interest.<sup>2</sup>

2.4.2. We believe this approach is consistent with general principles of fairness and integrity which provoke the need for proactive protection. These principles are affirmed in the policy objectives of the Bill to ensure protection of vulnerable consumers and responsible lending.<sup>3</sup> This purpose acknowledges the power imbalance and manipulation at play and the lack of choice or alternatives often present in this form of lending. Thus the same principles in this legislation should be applied to interest rates if a truly uniform and holistic strategy is to be present in this legislation to protect people from exploitation.

### 2.5. The interconnectedness of social harm and problem debt

2.5.1. In the Salvation Army’s experience exorbitantly high and increasing interest rates are now a significant cause in trapping individuals and families in a cycle of

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<sup>1</sup> MC Dale *Credit and Debt for Low-income and Vulnerable Consumers* (Child Poverty Action Group, January 2008), at 3.

<sup>2</sup> Proverbs 28:8; Exodus 22:25

<sup>3</sup> Credit Contracts and Financial Services Law Reform Bill (104-1) (explanatory note) at 2.

poverty that they are unable to extricate themselves from. Our budgeters are assisting clients who have been required to pay up to and over 600% rates of interest. These levels of interest repayment clearly make it impossible for some families to get out of debt and move from situations of dependency into a place of empowerment.

2.5.2. The effects of problem debt also disproportionately affect our some of our most vulnerable communities who are already facing barriers to having meaningful and healthy lives. Unscrupulous money lenders are targeting Maori, Pacific and low income New Zealanders to charge the extortionate rates.<sup>4</sup> The operation of Loan sharks target and thrive in low income communities because often consumers are borrowing for everyday needs such as food, fridges, bedding and clothing. For example clients at The Salvation Army have been referred to our budgeters after trading in fridges to pawn brokers to pay for food for their families. The debt repayment agreements that clients have signed when they are desperate have given lenders control over regular automatic payments out of their bank account, sometimes leaving no budget for food.

2.5.3. In South Auckland for example, loan sharks still outnumber the main banks and “clothing trucks” are common. Clothing trucks travel around low income communities selling basic essentials such as clothing, bedding, electrical goods, and sometimes food. The operation of these trucks is particularly concerning as they target people in their homes and aim to establish them as long-term clients. Also, some of the sales and purchase agreements are often extremely unclear and manipulative, with hidden high fees and rates of interest. For example, our budgeting staff and social workers have worked with clients in the past who have been threatened with a 16% interest increase *per day* if they are unable to pay their clothing truck debts by a certain date.

2.5.4. In the experience of Salvation Army budgeters the biggest creditor for many of their clients is the Government itself through fines and Work and Income overpayments. They have also had clients referred to them only when problem debt has already become significant, because of the rules surrounding the number of visits to Work and Income and eligibility for referral to budgeting services. We encourage an examination of these bigger issues if the Government desires a preventative and holistic approach to problem debt.

## 2.6. The need for innovative solutions

2.6.1. We encourage the introduction of the Code and fair lending principles in Part 1 cl 9B of the Bill<sup>5</sup> that require that borrowers are fully informed and all information provided is not misleading, deceptive or confusing. Financial literacy and full disclosure is essential to promoting fair lending that does not lead to problem debt. We believe that partnership with key agencies and NGOs will be vital in ensuring this, and for pursuing the aim of corporate social responsibility of lenders.

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<sup>4</sup> Kurt Bayer “Loan Sharks need tougher regulation- study” *The New Zealand Herald* (online ed, Auckland, 20 August 2012)

<sup>5</sup> At 16.

- 2.6.1.1. We submit that as part of Part 1 cl 9H and 9I which specifies prominent public display of terms, fees and annual rates of interest this could include a requirement to display or provide information regarding budgeting and financial literacy services so consumers can manage their finances more efficiently.
- 2.6.1.2. We also suggest that lenders should ensure that loan information is translated into key languages, or translation services are made public as part of ensuring that borrowers are fully informed of the agreement and its obligations. These translation services could be connected to the existing translation services that are already used by Work and Income. This would ensure that the terms of the agreement are indeed expressed in a “clear, concise and intelligible manner”.<sup>6</sup>
- 2.6.2. However research in New Zealand has found that financial literacy alone is not sufficient, as even consumers with good financial literacy felt they had limited choice.<sup>7</sup> The structure of the credit market in New Zealand does not provide sustainable borrowing options and affordable credit for low-income consumers.<sup>8</sup> This legislation provides an opportunity for investigating more socially responsible lending initiatives in New Zealand.
- 2.6.2.1. This may require leadership from government and could involve mainstream banks, such as the government-owned Kiwibank, credit unions and other community lenders.<sup>9</sup> Our budgeters have spoken of how they will always recommend Kiwibank to their clients because they are the only bank that will warn customers about signing over multiple accounts to debt repayment agencies, or prevent them from doing so.
- 2.6.2.2. Lessons could also be learnt from previous New Zealand schemes such as the one operated by the Māori Women’s Welfare League which ran for 17 years. The Child Poverty Action Group has suggested a microfinance instrument for vulnerable consumers that makes small short term loans available at close to the rate paid by banks’ preferred customers. The amount a particular consumer is able to borrow could increase as their successful repayment history builds. Work and Income could guarantee these KiwiBank loans, while refusing to guarantee loans provided under contracts from loan sharks with exorbitant interest rates.<sup>10</sup>
- 2.6.3. Part of socially responsible lending also requires access to dispute resolution services. The Salvation Army’s experience is that many people are either not aware these services exist or are reluctant to lodge complaints because of language barriers, different cultural views and approaches to dispute resolution, or a lack of time or resources. Salvation Army workers are already stretched in

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<sup>6</sup> Clause 9B(3)(b)(ii).

<sup>7</sup> M Anae and others *Pacific Consumers’ Behaviour and Experience in the Credit Market, With Particular Reference to the ‘Fringe Lending’ Market* (Ministry of Consumer Affairs, Wellington, 2007)

<sup>8</sup> MC Dale, above n 1, at 2.

<sup>9</sup> MC Dale, above n 1, at 4.

<sup>10</sup> MC Dale, above n 1, at 4.

advocating on behalf of their clients. Therefore transitioning cases to dispute resolution services must be streamlined to ensure true access and for the Bill's intent to be fully realised.

- 2.6.3.1. Agencies can investigate complaints about loans from lenders but only if the lender is registered with them. Therefore unregistered lenders will not fall within the parameters of the Code or the available dispute resolution services. We would like clarification on how those who are not registered are investigated and monitored.

### 3. RESPONSES TO SPECIFIC AMENDMENTS TO LEGISLATION

- 3.1. We propose an additional amendment to the Bill which follows practice in Australia, Canada and the US and explicitly caps interest rates.

- 3.1.1. The main claim against capping by critics has been robustly refuted. There is no empirical evidence that fringe lending could not be sustainable under a proposed 48% cap, and there are examples of sustainable small loan social enterprises operating in London and Australia with interest rates between 28% and 35%.<sup>11</sup> On balance, international research has found that caps provide a critical level of protection that significantly outweigh any disadvantages.<sup>12</sup>

- 3.1.2. The fear that setting a maximum upper limit in law will mean that the specified rate will become the de-facto interest rate charged by exploitative lenders is also logically flawed. This reasoning is not consistent with legislative regulation of other areas such as drug offences or crimes. Political leadership in the past in this area has accepted that strict and specific limits can be necessary to make a legal marker and statement to prevent harm to the vulnerable. We encourage the same political bravery.

- 3.2. Under cl 9B(3)(a) we ask for clarification as to the meaning of “reasonable inquiries” and “substantial hardship” and *how* will the lender know that the repayment won't cause substantial hardship for the borrower. We suggest more of an onus placed on lenders or those giving credit sales to investigate credit ratings on debts over certain amounts and on other existing insolvency commitments.

- 3.3. We support the limit of the new section 7A that stipulates that a credit contract cannot provide for a security interest over consumer goods such as bedding, cooking equipment, refrigerators and travel documents.<sup>13</sup> However we propose an additional subsection under this section that includes items of cultural or religious significance, which for many families can be of equal importance in their household.

#### 3.4. Summary of Key Recommendations:

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<sup>11</sup> Tolotea Lanumata, Louise Signal and Sharron Bowers “Punching loan sharks on the nose: Effective interventions to reduce financial hardship in New Zealand” (2012) 23 *Health Promotion Journal of Australia: Official Journal of Australian Association of Health Promotion Professionals* 108 at 109.

<sup>12</sup> Tolotea Lanumata, above n 11, at 110.

<sup>13</sup> Part 1 cl 9, at 15.

- **An amendment to the Bill** which follows practice in Australia, Canada and the US and explicitly caps interest rates.
- An expansion of the fair lending principle provisions that stipulate full disclosure and promote informed decision making.
- A practical commitment to socially responsible lending and innovative alternatives
- Clarification on certain terms within the Bill

#### **4. CONCLUSION**

The Salvation Army strongly supports the regulation of the consumer credit industry and the protection of vulnerable consumers. This Bill goes some way towards achieving this goal. However we believe that this principle cannot be fully achieved without a comprehensive and holistic strategy that includes addressing usurious interest rates and viable alternatives to loan sharks for some of our most our vulnerable communities.