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PROTECTING VULNERABLE CONSUMERS FROM OVER-INDEBTEDNESS

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I Introduction

This is a paper about protecting vulnerable consumers from over-indebtedness. The first part of this paper will outline what is meant by vulnerable consumers, over-indebtedness, and why these are the key concepts that this paper is framed around. As this paper is predicated on an assumption that vulnerable consumers ought to be protected from over-indebtedness, the second part of this paper defends that assumption. The third part of this paper is an exploration of three of the main causes of over-indebtedness, and which causes ought to be the ones that are targeted to help prevent the over-indebtedness of vulnerable people. The fourth part of this paper briefly outlines ways that the systemic problems that can cause over-indebtedness can be addressed. This paper argues that government subsidised low-cost loans, or cash grants, for people who are over-indebted due to vulnerability are an appropriate direction for further research that may be more welfare enhancing than other ways to address over-indebtedness caused by vulnerability.

II Focussing on Vulnerable Consumers and Over-Indebtedness

A Introduction

The first part of this paper focuses on vulnerable consumers and over-indebtedness. The paper is framed in these terms because consumers who are acting from a position of vulnerability should be protected from the amoral machinations of the open market. The same reasoning that makes general consumer protection appropriate, make extra protection for vulnerable consumers also appropriate.[1] This paper will outline the ways that consumers can be vulnerable, and how vulnerability can be considered a transitional state rather than a permanent class.

This paper is framed in terms of preventing over-indebtedness because consumer credit decisions can have significant long term effects of the quality of life of the consumers, and over-indebtedness can have a severely negative welfare impact on consumers.[2] In the discussion about over-indebtedness there will be an abstract discussion of why over-indebtedness is bad for consumers, and then an example using New Zealand based data to contextualise the problem.

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[1] Peter Cartwright "Understanding and Protecting Vulnerable Financial Consumers" (2014) 38 Journal of Consumer Policy 119.

[2] Therese Wilson "Responsible Lending or Restrictive Lending Practices? Balancing Concerns Regarding Over-Indebtedness with Addressing Financial Exclusion" in Michelle Kelly-Louw, et al. *The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems* (Ashgate, Hampshire, 2008) 91 at 100. (Wilson)

B Vulnerable Consumers

1 Introduction

Vulnerability is a particularly important concept in relation to consumer credit products because the products can be long term contracts for service, with a total cost that is often not clearly defined at the outset.[3] This means that the effects of a poor decision made in a moment of vulnerability can endure for a very long time. Cartwright[4] proposes that there are five ways that consumers can be vulnerable. These are informational, supply, pressure, redress, and impact vulnerabilities.[5]

2 Informational Vulnerability

Informational vulnerability arises when a consumer does not have the ability to understand the information relevant to making a good decision about consumer credit.[6] For example, they may not be able to read, may not understand key concepts like compound interest, or may not be able to critically evaluate claims made in advertising.[7] There tends to be a focus in literature on informational vulnerability, probably because it is also the least problematic in terms of compatibility with a free market conceptualisation of consumer credit agreements. A consumer acting under an informational vulnerability is not acting "…with perfect information…to make 'perfect,' rational choices thus enhancing the efficiency of the market."[8]

The antidote to this vulnerability is also the education and "responsibilisation"[9] of the consumer, pushing the responsibility for making perfect and rational choices[10] back on to the credit consumer. However there is a lack of empirical evidence that financial education has an "emancipatory"[11] effect on vulnerable consumers, probably because consumer credit products change frequently, are very complex.[12] Focussing on

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[3] Richard Tooth "Behavioural Economics and the Regulation of Consumer Credit" (2012) New Zealand Law Foundation and Sapere Reseach Group at 3.

[4] Cartwright, above n 1, at 119.

[5]Cartwright, above n 1, at 121.

[6] Cartwright, above n 1, at 121.

[7] Cartwright, above n 1, at 122.

[8] Therese Wilson, Nicola Howell, and Genevieve Sheehan "Protecting the Most Vulnerable in Consumer Credit Transactions" (2009) 32 Journal of Consumer Policy 117 at 121. (Wilson et al.)

[9] Wilson et al., above n 8, at 121.

[10] Wilson et al., above n 8, at 121.

[11] Donncha Marron "Governing Poverty in a Neoliberal Age: New Labour and the Case of Financial Exclusion" (2013) 18 New Political Economy 785 at 800.

[12] Marron, above n 11, at 800.

informational vulnerability as the critical element of vulnerability ignores the compounding effect of other vulnerabilities, such as supply vulnerability.

3 Supply Vulnerability

Supply vulnerability is when the credit consumer needs access to credit, and due to a limited supply of credit products available, they must take whatever consumer credit product is made available.[13] This vulnerability is particularly relevant when the consumer needs credit to facilitate access to "…products essential to health and well-being such as energy, food, and health care"[14] and it can lead to consumers accepting deals that "…can simply aggravate a bad cashflow situation, adding interest costs to an existing monthly shortfall."[15] It has been argued that "when hungry children are in the house"[16] it can be difficult for human beings to act with full economic rationality.[17]

4 Pressure Vulnerability

Pressure vulnerability arises when there is a "power asymmetry"[18] between a financial institution and a credit consumer where the credit consumer may feel inferior, powerless or intimidated and accept a disadvantageous deal because they do not feel entitled to, or are not able to, bargain with the financial institution.[19] This does lead to a question of how, in a market situation, a line can be drawn between "exploitative and persuasive"[20].

5 Redress Vulnerability

Redress vulnerability is when credit consumers do not know their rights, or do not have the tools or mechanisms to enforce their rights.[21] Different types of vulnerability can compound on each other,[22] for instance a consumer may feel inferior because they are behind on debt repayments, and so be unwilling to confront the financial institution when a penalty fee is mistakenly charged.

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13 Cartwright, above n 1, at 123.

14 Cartwright, above n 1, at 123.

15 Alan M. White "Credit and Human Welfare: Lessons from Microcredit in Developing Nations" (2012) 69 Wash & Lee L. Rev. 1093 at 1108.

16 White, above n 15, at 1103.

17 White, above n 15, at 1102-1103.

18 Cartwright, above n 1, at 123.

19 Cartwright, above n 1, at 123.

20 Cartwright, above n 1, at 123.

21 Cartwright, above n 1, at 123-124.

22 Cartwright, above n 1, at 125.

6 Impact Vulnerability

Impact vulnerability is when a consumer will "suffer more from making [poor] choices".[23] This vulnerability is linked to poverty, where the cost of a bad decision can impact a person living in poverty more adversely than it would a person not living in poverty.[24] Australian research suggests that "the loss of wellbeing as a result of incorrect choice is proportionally greater for an income support recipient than it is for someone on an average wage."[25] For example, a $20 unarranged overdraft fee will impact a person who can only afford to spend $20 on food every week more adversely than it will impact a person who can afford to spend $200 on food every week.

The way that the literature discusses impact vulnerability seems to tie the socioeconomic status of the consumer to their probability of vulnerability. While there is also research to suggest the "credit use and financial management were not easily linked to the participants levels of income, employment and education"[26], it is arguably appropriate that socioeconomic status (under the guide of impact vulnerability) be included as a factor for consideration, as most of the other vulnerabilities will be magnified where the consumer is also in a low socioeconomic group: "…being poor and subject to stressful financial circumstances can cloud one's judgement, making one far more receptive to disadvantageous business dealings."[27]

7 Permanent Class or Transitional Category

There are many ways that a person can be vulnerable, and many people may transition in and out of vulnerability based on their characteristics at a certain moment.[28] It has been argued that "many of us display elements of vulnerability in particular circumstances."[29] However, drawing a circle around the entire population and declaring all consumers of credit vulnerable risks blurring the distinction between poor choices that are later regretted, and poor choices that were made because the consumer was vulnerable.[30] Recognising that "some circumstances that cause vulnerability are longstanding, [and]

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[23] Cartwright, above n 1, at 124.

[24] Cartwright, above n 1, at 124.

[25] Linda Brennan, Zuleyka Zevallos, and Wayne Binney "Vulnerable consumers and debt: Can social marketing assist?" (2011) 19 Australasian Marketing Journal 203 at 205.

[26] Brennan, above n 25, at 205.

[27] A Best *When Consumers Complain* (Columbia University Press, New York, 1981)at 28 as cited in Cartwright, above n 1, at 123

[28] Cartwright, above n 1, at 121.

[29] Cartwright, above n 1, at 121.

[30] Tooth, above n 3, at 5.

others may arise extrinsically, almost overnight, and could affect anyone distinct from level of income or capability,"[31] any proposed protections should be designed with the understanding that there is not a binary classification of vulnerability, but degrees of vulnerability, and should not unduly restrict the whole consumer credit market.

Putting measures in place to protect all consumers as they transition in and out of vulnerability will, at the same time, "help protect the interests of a wide range of consumers".[32] The implementation challenge is then to acknowledge this general consumer vulnerability and make the consumer protections scalable to the degree of vulnerability in the specific consumer.

8 Conclusion

Conceptualising consumer vulnerability at the point of obtaining consumer credit products is a way to identify which consumers are deserving of extra protection.

C Over-Indebtedness

1 What is the Problem with Over-Indebtedness?

Consumer credit is the mechanism through which financial institutions lend money to individuals to "…enable individuals to borrow to meet their immediate needs"[33]. In the context of this paper, consumer credit is "the supply of credit for which interest or a fee is payable"[34] and is generally supplied in the form of "credit cards, personal loans, vehicle financing, hire purchase agreements, student loans and mortgages".[35]

Consumer credit also works as "as device to trade present consumption for future consumption"[36] which means that money consumed before it is earned must eventually be repaid to the lending financial institution. For some people, particularly the people who must borrow to meet their day-to-day expenses, debts can be extremely difficult to repay.

[31] Lorna Fox O'Mahony, et al. "Conceptualizing the Consumer of Financial Services: a New Approach?"(2015) 38 Journal of Consumer Policy 111 at 114.
[32] Cartwright, above n 1, at 121.
[33] Tooth, above n 3, at 2-3.
[34] Tooth, above n 3, at 2.
[35] Tooth, above n 3, at 3.
[36] White, above n 12, at 1101.

In New Zealand there is currently a very high level of consumer debt. According to the Reserve Bank of New Zealand (RBNZ), the average household debt in New Zealand in 1991 was 57% of nominal disposable income and in 2014 that percentage rose to 155%.[37] Research in Australia has suggested that "…mass consumption is now strongly linked to personal identity"[38], that people who cannot immediately afford to buy everything that they think they need use debt to maintain their lifestyle[39] and that "a significant cultural change seems to have taken place in the attitude of many Australians towards debt."[40] The data about debt in New Zealand from the RBNZ appears to support a hypothesis that a similar change has happened in New Zealand.[41]

The same RBNZ data set shows that the average percentage of nominal disposable income required to service the loans has not changed meaningfully over the same time period,[42] probably because while interest rates remain low the cost of servicing those loans is also low.[43] This means that while on average the total household debt in New Zealand has increased significantly, the average burden on households to repay it has not increased when expressed as a proportion of nominal disposable income.[44]

When expressed as an average across the population the harm of consumer credit is difficult to see. The harm of consumer debt does not necessarily attach to the largest debt, or the debt most disproportional to the nominal disposable income of the household. This is because the way that people in low socioeconomic groups are expected to participate in financial life is different to how the middle class is expected to participate. The middle class is encouraged into a "risk-embracing ethic"[45] of investing- leading to large debts for long term asset growth (like mortgages), where people in low socio-economic groups are "inducted into [the] more old-fashioned virtues of thrift and self-reliance"[46] that lead to defensive financial behaviour and risk reduction.[47] This means that much smaller debts

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[37] Reserve Bank of New Zealand "Household Debt" (21 September 2015) Reserve Bank of New Zealand <http://www.rbnz.govt.nz/statistics/key_graphs/household_debt/>
[38] Brennan, above n 25, at 204.
[39] Brennan, above n 25, at 204.
[40] Brennan, above n 25, at 204.
[41] Reserve Bank of New Zealand, above n 37.
[42] In 1991, on average 8% of nominal disposable income was required to service household debt. Reserve Bank of New Zealand, above n 37.
[43] Brennan, above n 25
[44] Reserve Bank of New Zealand, above n 37.
[45] Marron, above n 11, at 804.
[46] Marron, above n 11, at 803.
[47] Marron, above n 11, at 804.

become much bigger problems for people who are participating in financial life outside of “the cultural privileging of calculated risk taking”.[48]

A way to conceptualise the populations that are being harmed by over-indebtedness is to look at the data reported by the New Zealand Federation of Family Budgeting Services (NZFFBS). The NZFFBS records data about people who contact the NZFFBS and ask for help for managing their personal finances. In the 2014-2015 financial year 45,000 client families contacted the NZFFBS.[49] Those families on average owed $25,500 with $3,700 outstanding overdue payments when reaching the crisis that led them to seek help from the NZFFBS.[50] In the 2014-2015 financial year those families seeking help were disproportionately social welfare beneficiaries (74%).[51]

Social welfare beneficiaries in particular can find themselves “continu[ing] to get deeper into debt until the ‘debt cycle’ becomes a ‘debt trap’.”[52] People in a ‘debt trap’ (or, ‘over-indebted’[53]) can find themselves suffering from “…stress, depression, anxiety; become violent, suicidal, or homicidal; and face barriers to access to further credit and barriers to work.”[54] For people caught in continuous debt, “[a]s the debt burden worsens, so too does a sense of helplessness for these welfare recipients.”[55] Consumer credit is harmful when the disutility consequences outweigh the utility consequences of borrowing for the individual consumer.[56]

This paper is going to proceed on the basis that consumer credit is harmful when it to causes a person to become “trapped into accumulating unaffordable debt”[57] and is subjective to the characteristics of the consumer. For the purpose of this paper, when people are trapped in “accumulating unaffordable debt”[58] they are over-indebted.

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[48] Marron, above n 11, at 802.

[49] New Zealand Federation of Family Budgeting Services “Annual Statistics Summary” (15 September 2015) New Zealand Federation of Family Budgeting Services <http://www.familybudgeting.org.nz/wp-content/uploads/2015/09/NZFFBS-statistics-to-June-20151.pdf>

[50] New Zealand Federation of Family Budgeting Services “Figures show budgeting is needed as much as ever” (15 September 2015) New Zealand Federation of Family Budgeting Services <http://www.familybudgeting.org.nz/figures-show-budgeting-is-needed-as-much-as-ever/>

[51] New Zealand Federation of Family Budgeting Services, above n 49.

[52] Brennan, above n 25at 209.

[53] White, above n 12, at 1109.

[54] Wilson, above n 2, at 100.

[55] Brennan, above n 25, at 209.

[56] White, above n 12, at 1110.

[57] Brennan, above n 25, at 205.

[58] Brennan, above n 25, at 205.

2 Contextualising with Numbers

A useful type of vulnerability for contextualising the issue is impact vulnerability. This is an indirect way of identifying people who are living in poverty, or who have low incomes, as being vulnerable.[59] People on low incomes are also more likely to have limited access to "mainstream credit products"[60] which can drive them to use consumer credit products that are less reputable and more expensive,[61] and they also have less capacity to repay debt because they have less money to start with.

This is a useful element to focus on because a low income can be objectively defined, which can give scale and context for conceptualising the issues being covered in this paper. For the purpose of this paper, a person on a low income will be any person earning less than the full time adult minimum wage in New Zealand. After 1 April 2015, that is $590 gross per week.[62] This means that most social welfare beneficiaries are included in this range.[63] This is adopted only as a guideline for reference in this paper because the interpretation of 'low income' can vary significantly between different countries.

It is useful in this context to consider the data that is reported by the NZFFBS. The average total debt of families using their services was $25,500. If that debt was repaid that debt at a rate of 20% of gross income on the full-time minimum wage (i.e. repaid at $118 per week), with an interest rate of 13.95% per annum[64] the debt would take at least six years to repay and would include $12,681 in interest charges.[65] This assumes that 80% of the minimum wage income would meet all of the living costs and unexpected expenses for those six years, and also assumes that the low income consumer has access to mainstream consumer credit products with reasonable interest rates.

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[59] Cartwright, above n 1, at 124.

[60] Wilson, above n 2, at 92.

[61] Wilson, above n 2, at 92.

[62] New Zealand at Work "The Minimum Wage" (13 October 2015) Ministry of Business, Innovation & Employment <http://employment.govt.nz/er/pay/minimumwage/index.asp> based on 40 hours per week.

[63] Work and Income "Home" (13 October 2015) Work and Income <http://www.workandincome.govt.nz/individuals/brochures/benefit-rates-april-2015.html>

[64] Westpac New Zealand "Personal Loans Interest Rates & Fees" (13 October 2015) Westpac New Zealand Ltd. <http://www.westpac.co.nz/personal-loans/interest-rates-fees/> based on the lowest interest rate listed on 3 October 2015.

[65] Sorted.Org "Debt Calculator" (13 October 2015) New Zealand Commission for Financial Capability <https://www.sorted.org.nz/calculators/debt>

D Conclusion

This part of the paper has outlined and explained the concept of consumer vulnerability as a transitional state rather than a permanent class, and the ways that consumers can be vulnerable. Of particular interest is impact vulnerability, which appears to serve as an indirect way for consumers with low incomes to be vulnerable by definition. This paper then explained why over-indebtedness is a problem that vulnerable people should be protected from, and laid out an example of the finances of a person that is based on minimum wages, average rents and the average debt of people seeking budgeting help. This example was set out to contextualise the issue in New Zealand. The purpose of this section has been to outline the components of the issue that this paper will continue to explore.

III The Problematic Idea of Protecting People from Debt

A Introduction

This part of the paper will address some of the assumptions that are embedded in the framing of this issue. The way that the thesis statement has been framed is that vulnerable people ought to be protected from over-indebtedness, and has directed the discussion away from considering whether vulnerable people ought to be protected from all indebtedness. It has also been framed in a way that assumes that debt is something that people sometimes need to be protected from, which is not philosophically consistent in a free market that is populated with rational consumers. There is also an embedded assumption that there are some people who lack the capacity to financially participate in a way that is fully cognisant of financial realities. These assumptions are defended in this part of the paper.

B Access to Consumer Credit Products is Good for Consumers

The conversation about people living on low incomes and harmful consumer credit products necessarily raises the question of whether, for people living on low incomes, there can be non-harmful consumer credit products.

Access to mainstream consumer banking facilities helps people with low incomes to become “better subjects at managing their own poverty.”[66] Access to consumer credit products enables people living on low incomes to smooth consumption over time,[67] and research based on natural disaster recovery in the United States of America (USA)

[66] Marron, above n 11, at 788.
[67] White, above n 15, at 1106.

suggests that access to payday lending "help[s] alleviate problems for people in financial distress caused by a natural disaster."[68] Access to consumer credit can also enable people to dramatically improve their quality of life, for instance it can enable people who are otherwise financially dependent to leave abusive spouses and establish new independent lives.[69] In some situations, access to consumer credit products can be welfare increasing.

However, access to credit can also decrease welfare. As monthly shortfalls compound and interest costs must also be paid,[70] it can become difficult to distinguish between using consumer credit facilities to smooth the cost of irregular consumption needs, and using them to forestall the effects of outright insufficiency of income to live. Research suggests that people who are trapped in a poverty cycle are generally over-indebted because of habitual shortfalls in routine household costs.[71]

The effect of consumer credit products on welfare can be varied, however there are some benefits to it being available. There is also evidence that if there is to be access to consumer credit products, it can be welfare enhancing for people to have access to mainstream financial institutions[72] as well as fringe financial institutions.[73] The terms and products at fringe financial institutions are generally less favourable to borrowers[74] however there is evidence that mainstream financial institutions increasingly withdraw from low socioeconomic areas.[75] This withdrawal has several drivers, including modern banking systems being more efficient at market segmentation and more able to isolate high risk communities,[76] and that mainstream financial institutions do not want the reputational risk of lending to people with low incomes and subsequently being accused of engaging in irresponsible lending.[77] For many people with low incomes, access to affordable consumer credit with low transactional costs could be the difference between smoothing consumption costs, and an incremental descent into a 'debt trap'.[78]

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[68] Younghee Lim, Trey Bickham, Cassie M. Dinecole, Julia Broussard, Brittany E. Weber, Alethia Gregory "Payday Loan Use and Consumer Well-Being: What Consumers and Social Workers Need to Know about Payday Loans" (2014) 18 Journal of Poverty 379, at 390.

[69] White, above n 15, at 1111.

[70] White, above n 15, at 1108.

[71] Marron, above n 11, at 800.

[72] Marron, above n 11, at 789.

[73] Lim, above n 68, at 392.

[74] Lim, above n 68, at 382.

[75] Marron, above n 11, at 789.

[76] Marron, above n 11, at 789.

[77] Wilson, above n 2, at 98.

[78] Marron, above n 11, at 790.

Limiting access to mainstream consumer credit products can drive borrowers to fringe consumer credit products.[79] By the same reasoning, limiting access to fringe consumer credit products can drive borrowers to other informal consumer credit products that are even more difficult to regulate, or to bankruptcy.[80]

Access to credit can be welfare enhancing, but it can also be welfare decreasing and it depends on the situation. It is more likely to be welfare enhancing if it is from a mainstream financial institution, but credit from fringe financial institutions can also be welfare enhancing in some circumstances, and less welfare decreasing than informal and unregulated credit.

C Rationality and Paternalism

From a libertarian perspective the framing of this paper is objectionable, because there is an embedded assumption in this subject that there is such a thing as harmful consumer credit. When assessed through a utilitarian lens, there can be no harm in voluntary consumer credit agreements, because consumers are the people who are best placed to decide what products will best maximise their utility.[81] As consumers choose to incur debt in order to receive access to money in advance, through the theory of revealed preference it must be assumed that those consumers chose debt, on whatever terms they agreed to, over not having access to the money in advance.[82] Further, as consumers are best placed to know what products are best for them, regulators have no grounds to limit that credit seeking behaviour.[83]

This argument has several issues, including that when consumers use credit, they are often not so much expressing a preference to go into debt, as they are expressing "their basic preference to eat."[84] Consumers also are not perfectly rational actors, and instead tend to be overly optimistic about their future ability to repay debt[85] and also discount the preferences of their 'future selves' in favour of the preferences of their 'current decision making selves'.[86] This means that consumers are often not making rational decisions about their long term debt strategies, but are instead choosing the least-worst option

[79] Wilson, above n 2, at 99.
[80] Lim, above n 68, at 387.
[81] White, above n 15, at 1100.
[82] White, above n 15, at 1100.
[83] White, above n 15, at 1100.
[84] White, above n 15, at 1102.
[85] White, above n 15, at 1103.
[86] White, above n 15, at 1103.

available to satisfy current needs.[87] There is also an effect that advertising has of distorting the true preferences of consumers.[88]

This paper will continue on the basis that harmful consumer credit products can logically exist.

D Patronising Vulnerable People

However, the argument above about consumers sometimes not being rational actors is problematic because it relies on a view that people who have become over-indebted are not fully aware of what they are agreeing to, or the impact that their agreements will have on them in the future. A recurring characteristic referenced is that vulnerable people are not sophisticated consumers and lack knowledge about consumer credit products.[89] This is problematic because it removes agency from vulnerable people and discounts the knowledge and experience that people vulnerable people do have.[90]

It is arguable that many consumers are poorly educated about consumer credit products and this is not a characteristic unique to people who are vulnerable.[91] Consumer credit products are complex, change often, and many laypeople have difficulty understanding them.[92] While surveys focussed on people with low incomes report a general understanding of debt at a level of understanding an obligation to repay the money,[93] it is probable that there are many people who understand their consumer credit debt with the same kind of depth.

Similarly, it is probable that people vulnerable people do not need to be educated about the virtues of saving, as suggested by Brennan et al.[94] The challenge is likely not that vulnerable people do not know that they should save money, or do not want to save money, but that the there is no money left to save. This is a relevant issue to this paper because it is convenient to identify individual characteristics of people caught in a 'debt trap' and use those characteristics to explain a problem, rather than look at structural

[87] White, above n 15, at 1101-1105.
[88] White, above n 15, at 1104.
[89] Brennan, above n 25, at 205.
[90] Marron, above n 11, at 804.
[91] Tooth, above n 3, at 9-10.
[92] Tooth, above n 3, at 9-10.
[93] Brennan, above n 25, at 205.
[94] Brennan, above n 25, at 205.

issues around class, gender and race.[95] For instance, it is easier to identify people who have low literacy levels and attach their over-indebtedness to their inability to read the fine print of consumer credit contracts, than it is to consider that the systematic withdrawal of mainstream lending facilities from low income areas[96] might be the primary issue.

E Conclusion

Arguments about access to some debt being beneficial, economic rationality, paternalism and disempowering people who are vulnerable are difficult to resolve because it very much depends on the circumstances of the person, and the use of credit. People who are in a 'debt trap' will sometimes be there because of a preference to receive necessary medical treatment and be in debt, while others will be there because of a preference to own a brand new car. This part of the paper has served to highlight some of the underlying tensions that need to be balanced when trying to identify which consumer credit decisions were made as a result of unacceptable consumer vulnerability and deserve state regulation, intervention or relief, and moving toward a way to protect vulnerable people from over-indebtedness.

IV Causes Over-Indebtedness

A Introduction

This part of the paper will focus on what underlying issue is causing the symptoms described above. Access to credit is very important for financial participation in society.[97] Decisions about whether to access consumer credit products, what type of credit to use, and what types of goods or services to buy with consumer credit products, are decisions that most people make routinely. Consequently there are many and varied opinions about how debt ought to be used and managed that can range from pragmatism to moral judgement.[98] In this part of the paper three competing causes of over-indebtedness are set out. The first is that over-indebtedness is caused by poor decision making about credit use.[99] The second is that the imposition of objectively onerous terms is the cause of over-indebtedness. The third is that over-indebtedness is a symptom of poverty. This paper

[95] Marron, above n 11, at 792.
[96] Marron, above n 11, at 789.
[97] Marron, above n 11, at 795.
[98] Brennan, above n 25, at 204.
[99] Brennan, above n 25, at 204.

argues that all three of these causes contribute to over-indebtedness, however objectively onerous terms and underlying poverty are issues that can be systemically addressed.

B Poor Decision Making at Point of Credit Use Causing Over-Indebtedness

Consumer credit holds a conflicted place in society, all at the same time smart,[100] inevitable,[101] everyday,[102] dumb,[103] avoidable[104] and shameful,[105] depending on the qualities of the observer,[106] the qualities of the consumer,[107] and the particular goods or services purchased with the consumer credit. It is tempting to the view the problem of harmful consumer credit as being primarily about what the credit is being spent on or what type of consumer credit product is being provided. However, putting limits on certain types of spending with credit, or putting limits on certain types of credit products available would require some framework for deciding what type of consumer credit spending is permissible. That framework could only be developed by privileging certain types of consumer credit spending over others. Any decision would be made reflecting the inherent cultural biases embedded in the categorisation of debt uses. A particular distinction appears to exist between incurring debt that is investing for the future, versus the paying for day-to-day needs.[108] According to the New Zealand Commission for Financial Capability (NZCFC), speculating in the property market is 'smart debt' while borrowing to buy groceries is 'dumb debt'.[109]

Those recalling the sub-prime mortgage collapse of the early 2000's[110] or the 19% p.a. mortgage interest rates of the late 1980's (compared to 7% p.a. in 2015)[111] might be a little more reluctant to characterise mortgage debt so positively. Similarly a person who has no food may be reluctant to characterise debt to pay for groceries so negatively. A

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[100] Beverley Stevens "Watch out for new 'dumb debt' campaign" (18 November 2011) New Zealand Commission for Financial Capability <https://www.sorted.org.nz/blog/watch-out-new-dumb-debt-campaign>

[101] Brennan, above n 25, at 204.

[102] Brennan, above n 25, at 204.

[103] Stevens, above n 60.

[104] Stevens, above n 60.

[105] Brennan, above n 25, at 204.

[106] Brennan, above n 25, at 204.

[107] Brennan, above n 25, at 204.

[108] Brennan, above n 25, at 209.

[109] Stevens, above n 59.

[110] Pelma Rajapakse and Jodi Gardner "The Unconscionable Conduct and Consumer Protection in Subprime Lending in Australia" (2014) 29 Banking and Finance Law Review 485

[111] Reserve Bank of New Zealand, above n 37.

different framework for assessment, for example prioritising ‘need’ purchases over ‘want’ purchases, would yield an entirely different assessment of what type of debt is morally acceptable.

Defining the underlying problem as being poor decision making about credit use is problematic because it privileges certain types of purchases over others. There is also an intuitive solution to the problem, which is to limit access to “dumb”[112] credit. In the context of preventing people who are living in poverty from accessing harmful consumer credit products, this is could lead to discouraging the use of, or restricting access to, credit where it is most needed.[113] It may also lead to unintended consequences like financially excluding people who are living on low incomes from access to formal and regulated credit opportunities.[114]

This paper will not focus on common characteristics of the over-indebted because correlation is not the same as causation and it is difficult to determine whether the characteristics cause over-indebtedness, or vice versa, or if they are both caused by some third element.

This is not to say that consumers cannot make bad decisions, but that an attempt to use an objective framework to separate good decisions from bad decisions, or to pin over-indebtedness on being caused by characteristics of individuals, is fraught. Subjectively bad decision making is very difficult issue to address at a systemic level because of its subjectivity.

C Objectively Onerous Credit Terms Causing Over-indebtedness

The objectively onerous terms of some consumer credit products, like interest rates, penalty fees, and account fees, can also be identified as a cause of over-indebtedness. Unscrupulous lenders make an easy target, and setting limits the terms of consumer credit products seems like a very clear and reasonable course of action. Targeting objectively onerous terms probably would reduce the over-indebtedness of vulnerable people, and the number of people caught in a ‘debt cycle’.

[112] Stevens, above n 100.
[113] Wilson, above n 2, 105-114.
[114] Lim, above n 68, at 386.

However, as with limiting access to certain types of credit, putting limits on the rates and fees charged by financial institutions could have an unintended consequence of excluding people from regulated, formal financial institutions.

Credit terms can be objectively assessed, and can be easily and clearly regulated. This means that this is a cause of over-indebtedness that can be addressed systemically. However, objectively onerous credit terms are not the only cause of over-indebtedness, because the credit terms do not ask the question of why the over-indebted used the consumer credit products at all.

D Poverty Causing Over-indebtedness

Throughout this paper there has been an argument that access to some debt is good because it enables consumers to smooth consumption,[115] alleviate poverty and temporarily distribute wealth to where it is most needed.[116] Behind this argument there is an implicit acknowledgement that consumers do not consume evenly over time, that without access to consumer credit there are people who would lack the resources to tolerably manage their poverty, and that wealth does not always reside where it is needed. Without being explicitly called upon, one of the key reasons that people need credit at all is that they are living in poverty, with insufficient resources, and are able to borrow money to temporarily alleviate that poverty. This is not widely identified in literature as a problematic driver of over-indebtedness, which may because it is very obvious, or may be because it is a problem does not typically fit within the range of issues that can be meaningfully resolved by consumer credit law and regulation.

However, poverty, or an objective lack of necessary resources, can explain why some people who are over-indebted use consumer credit products to an extent that the repayment of the debt becomes unmanageable. Poverty is also a systemic issue that can be objectively assessed, and steps can be taken within the framework of consumer law and regulation to mitigate the effects of over-indebtedness on consumers who are living in poverty.

E Conclusion

This part of the paper has outlined three of the main drivers for people becoming over-indebted. Consumers are not all the same, and neither are over-indebted consumers. This

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[115] Lim, above n 68, at 387.

[116] Dawn Burton "Citizenship, Super-Inclusion and Consumer Credit Policy in Kuwait" (2015) 44 Journal of Social Policy 25 at 25.

means that it is not possible to pinpoint one dominant cause of over-indebtedness, because every consumer will have been influenced by different causes of over-indebtedness in different proportions. Some consumer credit decisions are subjectively bad decisions, some consumer credit terms are very reasonable, and some people are over-indebted for reasons other than poverty. However, the purpose of this paper is to isolate some of the contributing factors and consider how they can be managed in order to protect vulnerable consumers from becoming over-indebted.

V Addressing Systemic Issues

A Introduction

This part of the paper outlines some suggestions for addressing the causes of vulnerable people becoming over-indebted. To address objectively onerous terms, there is a short discussion about low cost government loans, or government-subsidised consumer credit products, for vulnerable people to get out of over-indebtedness. To address vulnerable people who are over-indebted because they objectively lack sufficient resources, there is a discussion about options for government grants and consumer credit default options.

B Addressing Objectively Onerous Credit Terms

Objectively onerous credit terms have been identified as one of the drivers that can lead to people becoming over-indebted. There are two ways to approach this. The first way is to approach it by creating limits that explicitly target people who are vulnerable or are already, or are near to, over-indebtedness. This option is not explored further in this paper, because as discussed earlier in the paper, limiting the ability of vulnerable or over-indebted people to manage their own poverty by consumption smoothing using consumer credit can be welfare reducing,[117] or drive them to informal or unregulated markets.[118] It also risks incentivising financial institutions to further exclude vulnerable people from mainstream financial participation as a reputational risk management strategy.[119] The second option is for the state to alleviate the effect of onerous consumer credit terms on vulnerable people by subsidising financial institutions to offer non-onerous consumer credit terms, or to provide loans with non-onerous terms directly.

To an extent, low cost government loans are available to some vulnerable credit consumers. Work and Income New Zealand (WINZ) is the operational government entity

[117] Lim, above n 68, at 387.
[118] Jay Weiser "Crony Consumerism" (2014) 66 National Review 37 at 2.
[119] Wilson, above n 2, at 93.

that delivers social welfare payments to social welfare beneficiaries in New Zealand.[120] One of the services that WINZ offers is advance payment of a welfare benefit when welfare beneficiaries have an “immediate need for something essential”[121] that can be repaid in instalments. This is effectively an interest free loan that is available several times a year, with increasing restrictions as use becomes more frequent. This availability captures people who are social welfare beneficiaries, effectively helping people that fit within a narrow definition of impact vulnerability combined with acting under the influence of pressure vulnerability. This type of low cost loan would be beneficial to people acting under the influence of most other types of vulnerability.

An alternative to no or low interest loans would be to subsidise mainstream financial institutions to loan to people who met certain criteria for supply and/or pressure vulnerability, on non-onerous terms. This would have the potential to achieve economies of scale for high risk borrowers, and reduce the potential for vulnerable people to become over-indebted by the mechanics of interest and penalty fees. It would also limit the extent to which the government was taking on an additional role in the financial ecosystem and leave consumer credit administration to financial institutions that specialise in that type of service. However a subsidy regime could also create perverse incentives for financial institutions to take advantage of the subsidy regime by becoming artificially less risk tolerant to attract subsidy payments, or by coaching consumers to frame their credit requirements in terms of pressure vulnerability. Interfering with the market could also divorce consumers from the negative consequences of becoming high risk credit consumers, and encourage more consumption, higher debt burdens and more risky credit use behaviour.

An issue with targeting objectively onerous credit terms is that it will not necessarily reduce the need that drives people to acquire progressively unaffordable debt. Making more affordable credit available would help people who are over-indebted because the interest and fees incurred are onerous. It would transfer the cost of their higher risk profile on to the government, and allow those people to get out of debt by focussing on the principal repayments, and then stay out of debt. However, for people who are over-indebted because they systematically do not have enough money for the necessities of life, this would merely slow the speed at which the debt became overwhelming.

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[120] Work and Income “Our Structure” (13 October 2015) Work and Income <http://www.workandincome.govt.nz/about-work-and-income/our-structure.html>

[121] Work and Income “Advance Payment of Benefit” (13 October 2015) Work and Income <http://www.workandincome.govt.nz/individuals/a-z-benefits/advance-payment-of-benefit.html>

C Addressing Poverty

Earlier in this paper, poverty and an objective lack of sufficient resources was identified as a reason why people become over-indebted. A way to address this is to create mechanisms that can give relief from debt. There are two ways to do this, either by directly giving people who are over-indebted the money needed to cancel the debt, or to have mechanisms for people to default on debt.

Giving money directly to people who are living in poverty has been trialled in a global context. The data that has been collected about recipients of charity in the form of cash transfers, in Mexico, Kenya and India suggests that alleviating poverty with a cash grant has long term positive welfare effects on the recipients.[122] Recipients in general did not spend the money frivolously, but instead on items like new roofs, new businesses,[123] healthcare and education.[124]

In Kuwait, if citizens can go before the courts and show genuine financial difficulty, the courts can show leniency on their debt and the government pays the debt on the citizen's behalf.[125] The social, political and economic context of Kuwait is quite different to the context of New Zealand, particularly because in Kuwait there is a very large resident population of non-citizens, and there is a great deal of government revenue generated by oil.[126] The culture of Kuwait is also heavily informed by the principles of Islam and Sharia law,[127] under which an inability to pay debt is considered to be a serious moral issue and an admission that debt has become unmanageable is to admit moral failing.[128]

The scale of poverty in the New Zealand context is quite different to that in a global poor context. Similarly, and attitudes toward debt in New Zealand are probably quite different to attitudes toward debt in Kuwait. This would mean that the outcomes could be less stellar, and the uptake of debt relief much higher. In New Zealand there are limited

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[122] Planet Money "What Happens When You Just Give Money to Poor People?" (25 October 2013) NPR <http://www.npr.org/sections/money/2013/10/25/240590433/what-happens-when-you-just-give-money-to-poor-people>
[123] Planet Money, above n 122.
[124] Freakonomics "Should We All Just Give Cash Directly to the Poor?" (6 April 2014) Freakonomics LLC <http://freakonomics.com/2013/06/04/should-we-all-just-give-cash-directly-to-the-poor/>
[125] Burton, above n 116 at 27.
[126] Burton, above n 116, at 27-29.
[127] Burton, above n 116, at 27.
[128] Burton, above n 116, at 38.

circumstances in which social welfare beneficiaries can receive grants[129] when they have urgent and necessary requirements and have no other way to meet these costs.[130] This is again restricted to people who are social welfare beneficiaries. A useful avenue of further research would be to quantify the cost that over-indebtedness has on the economy, in terms of loss of capital in interest to foreign banks, unemployment and underemployment caused by debt issues, lost productivity due to mental health issues, and provision and administration of services that help people who are over-indebted and suffering from associated negative consequences. It would then be interesting to consider what impact that cost could have if spread over people who are over-indebted because they were experiencing vulnerability, particularly impact vulnerability, at the time that consumer credit decisions were made.

A benefit of delivering cash grants to alleviate over-indebtedness is that the creditors would not lose money when borrowers are not able to pay their debts. A detriment is that it would separate vulnerable consumers from the consequences of their debt decisions, and it would separate financial institutions from the consequences of lending to high risk consumers. However, this could logically lead to lending terms becoming more favourable to consumers as pricing for risk would become less relevant.

An alternative approach would be to have mechanisms for defaulting on debt, including bankruptcy, No Asset Procedures and Summary Instalment Orders.[131] This is an option that is available in New Zealand,[132] however bankruptcy is a very stressful experience, before which significant financial hardship is often experienced.[133] It also often leads to creditors never recovering the debt,[134] and to the person who has declared bankruptcy being pushed further away from financial inclusion and participation.[135] This type of

[129] Work and Income "Special Needs Grant" (13 October 2015) Work and Income <http://www.workandincome.govt.nz/individuals/a-z-benefits/special-needs-grant.html>

[130] Work and Income, above n 129.

[131] Insolvency and Trustee Service "Will I Get My Money Back, and if so, When" (13 October 2015) Ministry of Business, Innovation & Employment <http://www.insolvency.govt.nz/cms/owed-money/will-i-get-my-money-back-and-if-so-when>

[132] Insolvency and Trustee Service "Responsibilities and Restrictions during Bankruptcy" (13 October 2015) Ministry of Business, Innovation & Employment <http://www.insolvency.govt.nz/cms/financial-trouble/personal/step3/bankruptcy/responsibilities-and-restrictions-during-bankruptcy>

[133] White, above n 15, at 1109.

[134] Insolvency, above n 131.

[135] Insolvency and Trustee Service "Step 2- Understanding the Consequences" (13 October 2015) Ministry of Business, Innovation & Employment <http://www.insolvency.govt.nz/cms/financial-trouble/personal/step2>

default action does not, on the face of it, appear to address the welfare of the person who was over-indebted or an equitable result for the financial institution that sold them the consumer credit product.

D Conclusion

In this part of the paper there has been a short discussion of the ways that the problems that create over-indebtedness could be addressed. This part of the paper has argued that limiting the terms available to people who are vulnerable, or having bankruptcy-type solutions are not helpful to solving the problems because they either are likely to create new problems, particularly exacerbated financial exclusion for vulnerable people. Instead, this paper has argued that low cost government loans, government subsidised loans, or direct cash grants to vulnerable people who are over-indebted, are solutions that could be usefully researched further or reviewed through a more operational lens.

VII Conclusion

This paper has been a discussion about how to protect vulnerable consumers from over-indebtedness. The first part of this paper focussed on how consumers can be vulnerable and why over-indebtedness is an issue that needs to be addressed.

This was followed by outlining why it may be considered problematic to attempt to protect people from their own consumer credit decisions. The paper outlined arguments about whether access to consumer credit products is good for consumers, whether that conceptualising any consumer credit decision as harmful to the consumer does not fit with the free market conception of rational consumers, and how the way that the conversation is framed around vulnerable people tends to be very patronising toward them and discounts their financial experiences. In this part of the paper it was argued that these arguments are underlying tensions that are problematic some of the time, for some consumer credit decisions, and for some vulnerable credit consumers.

This paper then discussed some of the causes of over-indebtedness for vulnerable people. These were a lack of self control and poor decision making, the imposition of objectively onerous credit terms on vulnerable people, and poverty as a driver for becoming over-indebted. This paper then outlined some proposed ways that that the causes for over-indebtedness could be addressed. This paper argued that providing government subsidies to facilitate low cost loans for consumers who are over-indebted due to vulnerability, or to provide cash grants to alleviate over-indebtedness and poverty, are ideas that should be researched further in the New Zealand context to determine whether they would work, and whether they are feasible to implement.

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