

Submission to Ministry of Business, Innovation & Employment on the Draft Responsible Lending Code

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Introductory remarks

1. The Commerce Commission has been responsible for enforcing and providing guidelines on the Credit Contracts and Consumer Finance Act 2003 (CCCFA) for over 10 years. Our work in this area aligns with our organisational purpose - to achieve the best possible outcomes in competitive and regulated markets in New Zealand.
2. We appreciate the opportunity to make submissions on the draft Code.
3. We recognise that lenders provide a valuable service to New Zealand consumers, and we are committed to protecting those consumers who seek to access credit. In our enforcement decision-making, and in the guidelines that we issue, we strive to balance our consumer protection objectives with ensuring that credit markets are competitive and operate efficiently.
4. The Credit Contracts and Consumer Finance Amendment Act 2014 (Amendment Act) gives lenders important new responsibilities. The Responsible Lending Code (Code) will elaborate on the lender responsibility principles (Principles) and provide important guidance as to the steps lenders should follow to comply with them. As such, the Code will be an important and much-referenced document in New Zealand's credit landscape.

The Commission's objectives for the Code

5. Our submission is aimed at assisting the Ministry of Business, Innovation & Employment (Ministry) to produce a Code that is useful, easy to understand and apply, consistent with the Principles and ensures:
 - 5.1 Protection for consumers.
 - 5.2 Certainty for lenders as to their obligations.
 - 5.3 Avoidance of unnecessary compliance costs for lenders.
 - 5.4 Effective enforcement of the Principles by the Commission.
6. The draft Code makes good progress toward achieving those objectives, but the Commission considers that further modifications are required before the Code does all of these things. We set out these issues in more detail below.

The potential consequences of a Code that is inconsistent with the Principles

7. Our key concern is to ensure that the Code is consistent with the Principles. The Commission's statutory remit will be to enforce the Principles, not the Code. The Code itself is not binding.
8. The Code is to elaborate upon and provide guidance upon the Principles only. If the Code is unclear, or if lenders interpret the Code as requiring a lower standard of obligation than is required by the Principles, the following problems may arise:

- 8.1 The Code could create exploitable opportunities for unscrupulous lenders and/or lead to inadvertent non-compliance by lenders relying on the Guidance in the Code as if it was sufficient to constitute compliance with the Principles.
- 8.2 Consumers may not be protected from all conduct that breaches the Principles.
- 8.3 Compliance costs increase, as lenders face uncertainty and will have to look outside the Code for guidance on compliance with the Principles.
- 8.4 Cost of enforcement increases, as the Commission is likely to take court action to clarify the proper relationship between the Code and the Principles.

This submission

9. Our submission is structured as follows.
 - 9.1 An initial “General Recommendations” section, which sets out submissions that relate to more than one section of the draft Code.
 - 9.2 Specific comments on sections of the draft Code. This section uses the same broad section headings as the draft Code.
 - 9.3 Attachment A contains a summary of our recommendations. Each recommendation is, where possible, cross referenced to specific sections of the draft Code; and specific paragraphs of this submission.
 - 9.4 Attachment B contains drafting comments.
 - 9.5 Attachment C contains suggested re-drafting of section 4 of the draft Code, as explained at paragraphs 19 and 20 of this submission.
10. We have not structured our submission with reference to the specific questions in the draft Code. However, many of those questions are addressed in our submission.
11. Section references are to the CCCFA as amended unless otherwise stated.
12. Page and paragraph references are to the draft Code unless otherwise stated.
13. Examples are included for illustrative purposes only and are a combination of credible hypothetical and “real life” scenarios.

General recommendations

This section sets out submissions that relate to more than one section of the draft Code.

The Code should emphasise the primacy of the Principles

Issue

14. The draft Code does not sufficiently emphasise the lender's primary obligation to comply with the Principles and, in places, may be interpreted so as to permit a lender to do less than they need to do in order to comply. This could create exploitable opportunities for unscrupulous lenders and/or lead to inadvertent non-compliance by lenders relying on the Guidance in the Code as if it was sufficient to constitute compliance with the Principles.
15. The 'overarching Principle', which gives meaning to all the Guidance found in the Code, is that:¹

... every lender must, at all times... exercise the care, diligence, and skill of a responsible lender...
16. We would like to see this Principle given due emphasis in the Code, as the source for all the subordinate Guidance in the Code.
17. The second Principle (compliance with the lender responsibilities) also requires emphasis, together with the fact that it is the responsibilities that are enforced by the Commission – not what the Code says about them.

Recommendation

18. We recommend that:
 - 18.1 An overarching statement should be included at the outset of each Guidance section to anchor the Guidance back to the relevant Principle. This will remind lenders that their primary obligation is compliance with the Principle, and the Guidance simply assists this objective.
 - 18.2 The Code should clearly state that while the way in which the lender discharges its obligation may vary (for example, due to the nature, currency and extent of the information the lender already has, and the borrower's past experience), the Principle itself does not vary and must always be met.
 - 18.3 The Code should retain existing content to the effect that a lender must be able to demonstrate that its conduct was reasonable and provided a sufficient basis for the lender to discharge its obligations under the Principles. This point should be made before specific inquiries are discussed.
19. We have suggested revisions to the Guidance at section 4 in Attachment C to emphasise the primacy of the Principle. These revisions can also be made to other

¹ Section 9C.

Guidance that refers to lenders exercising judgement or taking steps that could be regarded as falling short of the requirements of the Principles in certain circumstances.²

20. Our suggested revisions in Attachment C also reflect our recommendations below in relation to the “light touch” categories.³

Reasons

21. We agree that the Code should set out processes that assist with compliance, and that it should be sufficiently flexible to allow lenders to exercise judgment as to what is required in the circumstances. This may include making a judgment in each case about the number of inquiries made, the extent of information sought and whether the assistance provided is compliant. This judgment is an intrinsic part of responsible lending, which requires a lender to do what is necessary in the circumstances to comply with the Principles.
22. However, the Code should not create opportunities for a lender to follow a process or exercise its judgment in a way that leads to outcomes that are inconsistent with the Principles.
23. The key point is that while a lender may exercise judgement in relation to its *path* to compliance, it may not exercise judgment in a way that falls short of compliance with the substantive obligations set out in the Principles.
24. For example, a lender will need to decide what information a habitual credit card user needs to be given when taking out a new credit card. Whatever judgment the lender makes, the Commission will always be asking “has the lender exercised the care, diligence and skill of a responsible lender?”
25. The prominence (or lack of prominence) of the Principles in the Code is primarily a drafting issue, caused by the fact that Guidance on the process a lender must follow (or parts of that process that they are able to avoid) is not sufficiently anchored in the lender’s primary obligation to comply with the Principles.
26. We are concerned that the Code, in some places,⁴ suggests that adherence to the Code process will invariably amount to compliance with the Principles. Each lending situation is fact-specific, so the best that the Code can do is to recommend or guide lenders as to sound processes and procedures to implement the obligations set out in the CCCFA. The Code is not a safe harbour, and evidence of a lender’s compliance with the Code can only ever amount to evidence of compliance with the Principles.

² See in particular section 5 (5.6), section 6 (6.6, 6.7), section 7 (7.8), section 8 (8.11) and section 9 (9.14).

³ We use the term “light touch” to refer to the three key categories referenced in the Code: simple credit agreement, at 4.3(a) and 7.8(a); existing customer, at 4.3(b), 5.6, 6.6, 7.8(b) and 9.14; and experienced user of credit, at 4.3(c), 7.8(d) and 8.11(d).

⁴ For example, by focusing on the number of inquiries a lender should make or the amount of information they should obtain.

27. Our suggested revisions in Attachment C would shift the emphasis to achieving the desired outcome and clarify that the lender’s discretion may be exercised only in relation to how that outcome is achieved.

The “light touch” categories should be removed

Issue

28. The Principles set a minimum standard of behaviour that all lenders must comply with. That minimum standard cannot be diluted.
29. Yet the draft Code appears to establish a set of “light touch” categories such as “simple credit agreements”,⁵ “existing customers”⁶ and “experienced users of credit”.⁷ Our concern with these “light touch” categories is that they may lead lenders to believe that their obligations are reduced when dealing with loans or borrowers that fall into those categories. Again, the inference must be avoided that compliance with the Principles can somehow be “read down” in these cases.
30. We also believe that these categories, while they may have relevance in some lending situations, are an unsafe basis for lenders to abbreviate their inquiries or assistance.

Recommendation

31. We strongly recommend that the “light touch” categories be removed from the Code. They should be replaced with a list of factors that a lender can take into account when deciding what additional inquiries to make and what higher level of assistance to provide in circumstances in which the lender should “do more”. The categories at 4.2 could form the basis of this list of factors.
32. If the “light touch” categories are retained we recommend, at a minimum, that the “simple credit agreement” category should be replaced with a “small loan” category; and that the “existing customer” and “experienced user of credit” categories are amended.

Reasons

33. The light touch categories suggest that lenders may do less than is required by the Principles. This potentially undermines the consumer protection purposes of the CCCFA because it suggests that some borrowers (because of their past dealings with lenders or the type of agreement they enter into) need less protection than others. This is not borne out by our enforcement experience.
34. In our experience, past customers of a lender, or experienced users of credit, are frequently the subjects of questionable lending practices. We think these borrowers should be entitled to the full protection of the Code.

⁵ At 4.3 and 7.8.

⁶ At 4.3, 5.6, 6.6, 7.8 and 9.14.

⁷ At 4.3(c), 7.8(d) and 8.11(d).

35. To give an example: a borrower who frequently takes out payday or short-term loans in order to make ends meet might fall within the definition of “experienced user of credit.” But in our assessment, such a borrower should receive more – not less – information and assistance from a lender that is exercising the care, diligence and skill of a responsible lender.
36. We agree that – in some circumstances – a lender may not have to make some inquiries, or obtain some information, because of the characteristics of the borrower; or the simplicity of the loan agreement; or because the lender already has very recent information from the customer. The Code should make allowance for that.
37. However, rather than have “light touch” categories that can be interpreted as reducing the lender’s obligations, we suggest including a list of relevant factors that a lender can take into account when determining the extent of the steps it must take to comply with its obligations. A well drafted list of factors could remove ambiguity and be easier for lenders to follow, therefore better enabling compliance. This approach would also allow the Commission to more effectively enforce the Principles.
38. To conclude this recommendation: we see the inquiries listed in Guidance at 4.1 as “bare minimum” inquiries, and recommend avoidance of any suggestion that in any situation a lower level of inquiry could suffice. A lender should *always* inquire into what the lending is for, for how long, and for what amount.
39. We recommend that the Code emphasises that these inquiries will almost always be relevant, and that any suggestion (as in the Guidance at 4.3) that “fewer” inquiries than this may suffice is removed.
40. If the relationship between Guidance at 4.1 and 4.3 were maintained, we do not regard the draft Code as likely to provide adequate consumer protection or sufficient certainty for lenders.

Alternative recommendation: replace the “simple credit agreement” category with a “small loan” category

Issue

41. The draft Code implies that a lender may “do less” to be reasonably satisfied that a “simple credit agreement” that is “widely understood” meets the borrower’s requirements and objectives or to assist the borrower to reach an informed decision.⁸
42. In our experience problematic lending can involve simple credit agreements like credit cards and overdrafts. How a lender should take into account the nature of the product will depend on the circumstances.

⁸ At 4.3(a) and 7.8(a).

Recommendation

43. Guidance at 4.3(a) and 7.8(a) that refers to “simple credit agreements” should be replaced with an equivalent to 4.2(c) and 7.7(c), i.e. a credit agreement where the loan amount is small relative to the borrower’s ability to repay.

Reasons

44. The number of inquiries and amount of assistance should relate to the risk of the credit agreement to the borrower, rather than to the perceived complexity of the credit agreement. This alternative would better protect the interests of consumers, and provide a more readily assessable criterion for compliance and enforcement purposes.

Example 1: Caught out by a balance transfer deal

Mary accepts an offer to transfer her bank credit card balance to A Bank and pay 0% p.a. for six months. She doesn’t read the A Bank information as she’s had a credit card before and thinks she knows how they work.

Mary’s new A Bank credit card arrives and she uses the card when out shopping. A few months later Mary checks her statements for the first time and is surprised to see that her repayments have been applied to the balance transfer amount before the new purchases. Mary had made payments in keeping with expenditure on her shopping spree and to avoid interest accruing on those amounts. In fact she has been paying interest on her recent purchases while the payments were applied to the balance transfer amount.

A Bank may use the draft Code to argue that it did not need to provide a detailed explanation of the key features of the agreement to Mary, as she is an “experienced user of credit” and a credit card is a simple agreement that is widely understood. In fact, an interest free period is presumably a product feature the borrower wants, and should be explained. In this case, it was a product feature Mary was unfamiliar with, and as a result she was charged interest she was not expecting to pay.

Example 2: Credit obtained through credit card when personal loan declined

Andrew’s only source of income is an invalid benefit, and he is a problem gambler. Andrew obtained a credit card with a limit of \$3,000. Shortly afterwards, Andrew’s bank declined his application for a \$10,000 personal loan. Over the next three years, Andrew gradually increased his credit card limit to \$9,500. Andrew’s existing health difficulties worsened, and his parents argued that the stress of the debt contributed to his condition.

This example shows that problematic lending can happen with a simple credit agreement, an existing customer and an experienced user of credit. We question the rationale for suggesting that a lender can “do less” in these circumstances. While responsible inquiries may not have elicited Andrew’s gambling disorder, his total reliance on an invalid’s benefit would have been apparent and should have prompted additional inquiries each time Andrew’s credit limit was increased – especially since the bank had declined Andrew a similar-sized personal loan.

Alternative recommendation: amend the “existing customer” category

Issue

45. The “existing customer” category⁹ is an unsound basis for abbreviating enquiries and assistance, and is likely to capture borrowers who experience problematic lending.

Recommendation

46. The “existing customer” category should be re-drafted as follows:

an existing customer of the lender who has previously had the same or a similar credit agreement product provided by that lender before, without encountering any problems or repayment difficulties:

Reasons

47. What is relevant in this category is that:
- 47.1 the lender will already have some information about the borrower if they are an existing customer; and
 - 47.2 an existing customer may have a degree of existing knowledge about the lender’s products.
48. However, the extent of the knowledge and information in each case is critical, not the mere fact that the customer is an “existing customer”.
49. This category should not include existing customers who have had a “similar” credit agreement before. Extending this category to “similar” credit agreements introduces an unacceptable level of uncertainty. For example, it is unclear whether a “gold” credit card with travel insurance is sufficiently “similar” to a low-interest credit card. While both products are credit cards, the fees, interest rates and benefits will usually differ materially.
50. The relevant comparison to be drawn is between products provided by the same lender. For example, a home loan with Bank A may be very different to a home loan from Bank B due to lender specific variables such as each bank’s credit rating and standard terms of business. Furthermore, Bank A might not know enough about Bank B’s product to make an accurate assessment of what that means in terms of the borrower, for example their level of experience or financial literacy.
51. If “similar” credit agreements are excluded, a further change will be required for workability. The word “agreement” could be replaced with “product” to accommodate variations in pricing, such as interest rate.
52. The way the category is defined should also require the existing customer to have had the same credit product *without encountering repayment difficulties*. Without this wording, a lender may look to this category to justify making fewer inquiries in

⁹ At 4.3(b), 5.6, 6.6, 7.8(b) and 9.14.

relation to an existing customer that has had difficulties with the same product in the past.

Example 3: Beneficiary with previous problematic loan offered further credit

Tony's WINZ benefit was subject to an attachment order (a Court order deducting an amount from his wages to repay a judgment debt) of \$75 per week to repay an existing debt. When the debt was finally paid off Tony's bank offered to lend him \$15,000, even though he had experienced extreme difficulty in repaying his last loan. While it may be argued that Tony could afford \$75 per week as he had managed to eventually repay his previous debt on that basis, the inference from the attachment order is that he can't really afford it.

This example shows that problematic lending does happen in circumstances involving existing customers, and supports our submission that this "light touch" category should be restricted to borrowers that have not encountered any problems or repayment difficulties in the past.

Example 4: The seasonal worker with the expensive car

Claire, a young seasonal worker, applied to Y Finance for a personal loan to buy an expensive car. Claire was an existing customer of Y Finance, and had had a personal loan before. Y Finance approved the loan on the basis of information it already held about Claire. Claire's work ended at the end of the season and she was unable to find another job. Claire was able to make the repayments, but could not afford her utility bills.

Y Finance did not take account of the fact that Claire's job was only for one season, but may use the draft Code to argue that it exercised judgement and acted reasonably on the basis of information it had about Claire as an existing customer. Even cursory inquiries of Claire by Y Finance would have elicited the information that her employment (and therefore her ability to repay) was temporary.

Alternative recommendation: amend the "experienced user of credit" category

Issue

53. The definition of "experienced user of credit" is over-broad, and likely to capture borrowers who are not sufficiently experienced or sophisticated to protect themselves from problematic lending.
54. The definition implies a judgment based on repeat use of credit without an adequate assessment of how successful (or unsuccessful) the borrower has been at managing and repaying that credit. It could be interpreted as including unsophisticated borrowers and habitual borrowers who use credit unsustainably, but have not (as yet) missed a repayment.

Recommendation

55. The definition of "experienced user of credit" should be re-drafted as follows:

The Code treats as an **experienced user of credit** an individual:

- who has ~~had experience as been~~ a borrower under ~~a similar~~ the same credit ~~agreement~~ product provided by that lender recently (for instance, in the previous two years) without encountering any problems or repayment difficulties; and
- ~~who appears to be fluent in English~~ who is not a vulnerable consumer; and
- who is not seeking to be a borrower or guarantor under a high-cost short-term credit agreement.

56. A new definition of “vulnerable consumer” should be included. This definition should be drafted widely to capture consumers who are particularly vulnerable to harmful lending practices because of factors such as limited proficiency in English, low financial literacy, low income, desperation caused by straitened financial circumstances and few options to access credit. This definition could also be used in Guidance on circumstances where a lender should “do more”.¹⁰

Reasons

57. The draft Code suggests that lenders may “do less” in relation to an “experienced user of credit”.¹¹ In the light of the concessions suggested for “experienced users of credit”, the definition in the Glossary needs to be more explicit about who is an experienced user of credit. This will provide certainty for lenders, by giving more clarity as to which borrowers are included in this category and better protections for those who may be frequent, but not sophisticated, users of credit.
58. The first bullet point should be amended to replace “a similar credit agreement” with “the same credit product provided by that lender” for the reasons set out at paragraphs 47 to 51 above.
59. The second bullet point should refer back to a new definition of “vulnerable consumer”. This would make it clear that individuals that have other characteristics that may make them vulnerable cannot be “experienced users of credit”.
60. The example below illustrates the failure of a lender to be satisfied that it is likely that the credit will meet the borrower’s requirements and objectives. This was due to the lender’s failure to make reasonable inquiries because it was dealing with an experienced user of credit.

¹⁰ For example, at 4.2(d), 5.5(d), 6.5(c), 7.7(e), 8.10(c) and 9.13(b).

¹¹ At 4.3(c), 7.8(d) and 8.11(d).

Example 5: Making extra mortgage repayments

Miriam has an X Bank floating rate mortgage on the family home and is an experienced user of credit (according to the definition in the draft Code). Miriam regularly makes extra repayments to pay down her mortgage faster. She switches to a Z Bank fixed rate mortgage, and is surprised to find that a fee will apply if she wants to continue making extra repayments.

If Z Bank had made even cursory enquiries into Miriam's requirements and objectives, it would have discovered that she wanted to continue making extra repayments and therefore that a fixed rate mortgage was unlikely to meet her requirements and objectives. Z Bank could have recommended that Miriam retain her existing floating rate mortgage, or suggested another product more likely to meet her requirements and objectives.

Guidance about how a lender can be satisfied that the credit will meet the borrower's requirements and objectives omits important considerations*Issue*

61. The Code omits important considerations when providing Guidance about how a lender should assess whether credit meets the borrowers' requirements and objectives:
 - 61.1 It does not require the lender to consider whether it has other suitable products or product features that could reduce the cost of borrowing.
 - 61.2 It does not require lenders to consider the purpose for which the credit is sought, which we think is relevant to an assessment of the suitability of a particular credit product for the borrower's requirements and objectives.

Recommendations

62. The Code should require a lender to consider:
 - 62.1 whether it has other suitable products or product features that could reduce the cost of borrowing and meet the borrower's needs; and
 - 62.2 the purpose for which the credit is sought.

Reasons – other products or features that reduce the cost of borrowing

63. For many borrowers, obtaining credit at the lowest cost will be at least one of their key objectives. This is not explicitly recognised in the draft Code and, as a result, we think there is a risk that lenders will not take account of this factor when attempting to comply with this Principle.
64. The Code should explicitly address the role that cost of borrowing plays in the lender's assessment of whether it is likely that the credit will meet the borrower's requirements and objectives. For example the draft Code suggests that "providing short term credit to meet a long-term need would be unlikely to meet the requirements and objectives of the borrower". The draft Code does not, however, state that such a loan is unlikely to meet the borrowers' requirements and objectives

because it is likely to be cheaper overall for the borrower to obtain credit for a longer term.

65. The lender should be required to consider, taking into account any other requirements and objectives the borrower has, whether the borrower could reduce its cost of borrowing by:
- 65.1 taking any other suitable products that the lender has available;
 - 65.2 using any other features of the products that the lender has available.
66. This Principle dovetails with the Principles requiring a lender to assist a borrower to make an informed decision and to be reasonably satisfied that the borrower will be able to make payments without suffering substantial hardship:
- 66.1 Where a particular product or feature required by the borrower results in an increase in the cost of borrowing, the lender should explain this to the borrower to comply with its responsibility to assist the borrower to make an informed decision.
 - 66.2 If using a particular product or feature is likely to mean that a borrower cannot make payments without suffering substantial hardship the credit will not meet the borrower's requirements or objectives.

Reasons – purpose for which the credit is sought

67. It is essential that lenders understand the purpose for which the credit is sought in order to comply with this Principle. Without this information the lender cannot assess whether the type, length, rate, terms, special conditions, charges and other aspects of the proposed credit agreement meet that purpose.
68. Without an inquiry into the purpose for which the credit is sought, the lender will not uncover important information it needs to discharge its obligations under the Principles. For example, making the limited inquiries at 4.1 of the draft Code may not uncover that a prospective borrower needs a new credit card to pay off their old credit card that is in arrears as a result of uncontrolled spending; or high-cost short-term credit to pay rent or buy groceries.
69. The examples in the Code make it clear that it is important to understand the purpose for which the credit is sought. A lender cannot ascertain whether a need is “long term” or “short term” unless it knows what the need is.

Example 6: Purpose for which the credit is sought

Wiremu applied online for an overdraft from X Bank. As part of the application process, Wiremu checked a box that he wanted credit for expenditure on a one-off basis. Wiremu in fact wanted the overdraft to pay for a holiday.

X Bank should have inquired into the purpose for which the credit was sought. If it had, it would have discovered that Wiremu wanted to pay for a holiday and could have mentioned a revolving credit agreement as a lower cost alternative.

70. This recommendation is consistent with the position in Australia. The Explanatory Memorandum to the Australian National Consumer Credit Protection Bill 2009 states that the **minimum** required of credit licensees in order to meet the obligation to make reasonable inquiries about a consumer's requirements and objectives will be to understand the purpose for which the credit or consumer lease is sought.¹²
71. This is reflected in the Australian Securities & Investments Commission's Regulatory Guide 209 (Credit licensing: Responsible lending conduct), November 2014 (ASIC Regulatory Guide 209). ASIC Regulatory Guide 209 states that, depending on the circumstances, reasonable inquiries about a consumer's requirements and objectives could include inquiries about the purpose for which the credit is sought and the benefit to the consumer.¹³
72. An inquiry into the purpose for which the credit is sought would be made to obtain the information the lender needs to comply with the Principles, not for the purpose of making a moral judgment and restricting access to credit accordingly.
73. The information gained during these inquiries is also likely to be relevant to the lender's assessment of substantial hardship.
74. A lender will also need to tell the borrower about appropriate alternative products in order to satisfy its obligation to assist the borrower to reach an informed decision. A key part of making an "informed" decision is understanding what the alternatives are. A borrower that is not aware of other products in the lender's product suite that may meet its requirements and objectives cannot be said to be making "an informed decision as to whether or not to enter into the agreement." This is illustrated by the example below.

Example 7: Suitability and alternative products

Marama applies to her bank for a standard credit card. A standard credit card might meet Marama's requirements and objectives in that it will provide her with access for credit in emergencies. However, Marama is planning to spend the next six months travelling and intends to make only minimum monthly repayments during that time. The bank should mention that it also has an Airpoints credit card and a low rate credit card that Marama may wish to consider. An Airpoints credit card might be more suitable if Marama wishes to accumulate Airpoints to put towards future travel. A low rate credit card might be more suitable if Marama wishes to minimise interest charges while she is overseas.

¹² Explanatory Memorandum, paras 3.68 and 3.138.

¹³ RG 209.33(c).

More Guidance on and examples of unsuitability

Issue

75. The draft Code implies that certain products are not suitable in certain circumstances, but does not include sufficient Guidance or examples to provide certainty for lenders. For example:
- 75.1 the warning at 3.7(a) implies that high-cost short-term credit is not suitable for long-term borrowing; and
 - 75.2 the example at 4.9 implies that a store card may not meet the requirements and objectives of a borrower that does not seek ongoing access to credit.
76. This issue dovetails with our earlier discussion in relation to the purpose for which the credit is sought (see paragraphs 61 to 74). If the lender does not know the purpose for which the credit is sought it cannot make an adequate assessment of suitability or whether the product is likely to meet the borrower's requirements and objectives.

Recommendation

77. The draft Code should include specific Guidance on unsuitability and examples of unsuitable products that will not meet the borrower's requirements and objectives in certain circumstances. For example, a "low doc" home loan may not meet the borrower's requirements and objectives if the borrower would qualify for another home loan with the same lender with a lower cost and/or more features.¹⁴

Reasons

78. Product suitability is an important part of the assessment required by section 9C(3)(a)(i) of the CCCFA. Further Guidance and examples would bring this to the fore and provide more certainty for lenders.

Example 8: Store credit and suitability

Sadaf wishes to buy a new television from N Appliances on credit, as N Appliances is advertising 12 months interest free. N Appliances facilitates Sadaf's access to credit by helping her apply for a third party credit card, offered by E Finance. The television from N Appliances is \$1,600, however the credit limit on Sadaf's new E Finance credit card is \$5,000. Sadaf has been given access to \$3,400 of credit she did not request, and soon spends it on other purchases she would not have made under normal circumstances. This is an example of credit that is unlikely to meet the borrower's requirements and objectives. Sadaf's requirements and objectives were to access \$1,600 of credit and 12 months interest free for a one-off purchase, not to sign up for a credit card with a \$5,000 limit for use on an ongoing basis.

¹⁴ See the Australian Securities & Investments Commission Report 410, *Review of 'low doc' home lending following the introduction of responsible lending obligations*, September 2014.

The definition of “high-cost short-term credit” should be wider

Issue

79. The definition of “high-cost short-term credit” is drafted too narrowly. It excludes agreements in relation to which lenders should “do more” or be prevented from relying on “light touch” categories to “do less”.

Recommendation

80. The definition of “high-cost short-term credit” should be amended as follows:

Lenders under high-cost short-term-credit agreements should follow Guidance identified as applying to those agreements. The Code treats high-cost short-term-credit agreements as those agreements where:

- The agreement is not a continuing credit agreement; and
- ~~The loan amount is small (for instance, less than \$2,000 will be small); and~~
- The period for repayment is short (for instance, within ~~3~~12 months will be short); and
- ~~The loan is likely to be unsecured; and~~
- The annual interest rate is high relative to bank personal borrowing rates (for instance, 50% p.a. or above) or mandatory fees are high relative to the amount of credit.

81. A definition of “continuing credit agreement” should be included.

Reasons – general

82. The definition of “high-cost short-term credit” is important as the defined term is used in Guidance that establishes important consumer protections, for example circumstances in which lenders should “do more” or cannot rely on “light touch” categories to “do less”. It is critical to the fulfilment of the primary purpose of the CCCFA that this definition is drafted as clearly and as widely as possible.

83. Our recommendations to remove the requirement of amount; increase the concept of “short-term” from three months to 12 months; and remove the reference to security would all be consistent with the Glossary definition of “high-cost short-term credit” UK Financial Conduct Authority Handbook.

Reasons – defining “continuing credit agreement”

84. A definition of “continuing credit agreement” would provide greater certainty for lenders. Without a definition it is unclear what this term actually means.

Reasons – removing amount

85. We understand that comparable overseas definitions¹⁵ have used value as a consideration, however we are not persuaded that this is a useful or “real world” characteristic of these high risk loans.
86. High-cost short-term credit is problematic as it expensive, high-risk and is often used by vulnerable borrowers who have limited credit options. This is true regardless of the amount involved. In fact, a large high-cost short-term credit agreement is

¹⁵ In particular, definitions of “short-term credit contract” and “small amount credit contract” in the Australian National Consumer Credit Protection Act 2009.

potentially **more** problematic for the borrower than a small high-cost short-term credit agreement.

87. Lenders should “do more” in relation to **all** high-cost short-term credit agreements, regardless of amount. Removing the requirement of amount would focus the definition on the source of the problem – high-cost short-term credit – and give better effect to the updated purposes of the CCCFA. Removing this requirement would also enhance certainty and give unscrupulous lenders less scope for “gaming” the definition.

Reasons – increasing “short-term” from 3 months to 12 months

88. Three months is a very short period and would only really capture “immediate need” loans. A longer period of 12 months would capture loans that have the same essential problem characteristics.

Reasons – removing “likely to be unsecured”

89. This limb of the definition could be interpreted in a way that excludes some secured high-cost short-term credit agreements. This is concerning as we understand that many short-term credit agreements are secured.
90. The phrase is vague and unclear as it suggests that security may be a factor in certain circumstances, but provides no Guidance on what those circumstances are.
91. This limb does not elaborate on the critical qualifications for the purposes of the definition, being credit that is “high-cost” and “short-term”, i.e. likely to be high risk for the borrower.

It is not enough to simply have a good compliance policy

Issue

92. The draft Code does not sufficiently emphasise that the primary function of an adequate compliance policy is to enable a lender to comply with the Principles. A process that does not facilitate compliance (or have compliance as a key focus) is unlikely to meet the requirements of the Principles.

Recommendation

93. Include commentary in the Introduction to the effect that references to compliance policies in the Code are references to compliance policies that contain content that would, if followed, achieve compliance with the Principles.
94. Guidance at 2.3 to 2.5 should make it absolutely clear that simply having a policy will not evidence compliance with the Principles unless that policy:
- 94.1 contains content that would, if followed, achieve compliance with the Principles;
 - 94.2 is fully embedded in the lender’s business;

94.3 is followed by the lender and its representatives and agents; and

94.4 is reviewed and amended as required.

95. Guidance in the draft Code referring to compliance policies should be reviewed and strengthened to emphasise substance over form. Compliance itself is a separate achievement to the existence of an adequate policy. The Guidance should make it absolutely clear that the content of a compliance policy must achieve the objectives of the Principles.

Reasons

96. Our recommendations are designed to anchor references to compliance policies back to the relevant Principle and shift the focus from process to the required outcome. This should shift the focus of lenders from the development of compliance policies to compliance with the Principles.

It is not enough to simply record that a good compliance policy has been followed

Issue

97. The draft Code states that a record of how the lender applies the Guidance may be in the form of a compliance policy and a record of any departures from that policy (unless the policy provides for such departure).¹⁶ Subsequent wording states that the fact that a lender complies with this Guidance does not mean that a Court will accept those records as sufficient proof of the actions a lender took in any individual transaction.¹⁷
98. Despite this subsequent wording, the primary message to lenders is that the existence of a policy and a simple note that it has been followed can be sufficient proof of the actions taken in an individual transaction, regardless of the substance of the policy or its substantive requirements. This is unlikely to be the case.

Recommendation

99. The “or” at the end of 2.9(a), 4.10(c)(i) and 5.16(c)(i) should be deleted and replaced with “and”. This would require lenders to keep records in the form of the actions they take in each individual transaction **and** their compliance policies.

Reasons

100. We do not think that it is a sufficient record to simply document that compliance policies have been followed. The lender should ensure that it has:

100.1 records of its actions in each individual transaction;

100.2 sufficient evidence that it has followed compliance policies that achieve the objectives of the Principles and Guidance; and

¹⁶ At 2.9(b), 4.10(c) and 5.16(c).

¹⁷ At 2.10, 4.10 and 5.17.

100.3 sufficient evidence that it has met the requirements of the relevant Principle through following those compliance policies.

101. We would expect that a lender that has followed its standard procedures or compliance policies would have a clear documentary trail. Without this, it will be difficult for a lender to demonstrate compliance with the Principles. We have some serious concerns about any provision in the draft Code that suggests that lenders can abbreviate their actions simply by stating that they had followed their standard procedures.
102. We are also concerned that a lack of transaction-specific evidence will make it difficult for the Commission to enforce the Principles. Without transaction-specific records the Commission may be forced to rely on the imperfect recollections of the lender and the borrower to try and ascertain the facts, turning enforcement into a “he said, she said” debate.

Advertisements should always disclose an annual interest rate

Issue

103. Advertisements that do not disclose an annual interest rate make it harder for consumers to shop around for credit or to make fully informed decisions about a lender’s product. In order to find out the cost of credit, consumers must go to the lender’s premises or website, at which point they are more likely to enter into a credit agreement.

Recommendation

104. The Code should require an annual interest rate (and a note if that rate is variable) to be disclosed in **every** credit advertisement.

Reasons

105. We support Guidance that requires a lender to display with equal prominence an annual percentage interest rate (and note if that rate is variable) when referring to an interest rate or an amount of interest.¹⁸ This will help protect consumers who are often confused by advertisements that refer to monthly, weekly or daily interest rates. In our experience debtors compare these headline rates favourably to annual interest rates charged by banks and other first tier lenders, when in fact they are significantly higher.

¹⁸ At 3.4(b)(i).

Example 9: Advertising of interest rates

The Commission issued a compliance advice letter under the Fair Trading Act to a lender who was advertising “only 8%”, with only fine-print indicating that this rate was per week.. The annual interest rate was 416%.



106. This Guidance should go further, and say that an annual interest rate (and a note if that rate is variable) should be disclosed in **every** credit advertisement.
107. Disclosure of an annual interest rate up-front is important, as it ensures that the consumer appreciates the true position from the advertisement, before progressing to the lender’s premises or website. Once a prospective borrower has entered the lender’s domain, he or she will be more likely to enter into a credit agreement with the lender. The advertisement will have contributed to that decision, even if the borrower understands the annual interest rate by the time they actually enter into the agreement.
108. Disclosure of an annual interest rate in credit advertisements would be more consistent with the updated purposes of the CCCFA. It would better protect the interests of consumers through up-front disclosure of a key term of the agreement. It would promote the confident and informed participation in credit markets by consumers by giving them, up-front, the key information required to compare products and shop around for credit. It would promote and facilitate fair, efficient and transparent credit markets through consistent disclosure, comparability and competition.

All assessments should be objective and apply genuinely reasonable standards of care*Issue*

109. The draft Code uses words like “aware” and “suspects” which appear subjective and will be difficult to assess in practice. In one case, the use of “aware” creates an unrealistically high threshold from an enforcement perspective.¹⁹

¹⁹ At 7.15.

Recommendation

- 110. All assessments should be objective and apply genuinely reasonable standards of care.
- 111. The word “aware” at 7.15 should be deleted and replaced with “aware or ought reasonably to have known”.
- 112. The words “reasonably suspects” at 7.13 should be deleted and replaced with “ought reasonably to have known”.

Reasons

- 113. Guidance at 7.15 applies where the lender is “aware” that the borrower has not understood the key features of the agreement. This threshold is too high and may require the borrower to actually tell the lender that they do not understand or the lender to test for comprehension – neither of which is likely to occur.
- 114. Our recommended amendment to 7.15 will set a more realistic threshold and mitigate some of the subjectivity inherent in the word “aware”. It will also potentially have more value as a legal term from a compliance and enforcement perspective.
- 115. This reasoning also applies to the reference to “reasonably suspects” at 7.13.

Striking the right balance: compliance costs*Issue*

- 116. Where tension arises between the primary consumer protection criterion and the secondary criterion of minimising compliance costs, the balance should weigh in favour of consumer protection. Consumer protection should not be traded off against reduced lender compliance costs, or the provision of credit by lenders who are not compliant with the Principles.

Recommendation

- 117. The Ministry should focus on costs that are:
 - 117.1 evidenced by lenders, i.e. by carefully considered cost estimates that do not include “business as usual” costs;
 - 117.2 clearly “unnecessary” because they do not give effect to the purposes of the updated CCCFA, the Principles or the lender responsibilities; and
 - 117.3 genuine increased costs of doing business (such as day to day monitoring and compliance costs) rather than “one off” set up costs (such as developing a compliance policy).

Reasons

118. Compliance with the Principles will involve some cost for lenders. This path was set when the Amendment Act was passed, and some compliance costs are an inevitable consequence of the shift to a responsible lending environment.
119. Minimising those compliance costs is a criterion that forms part of the framework for the Guidance in the draft Code. However, while minimising compliance costs is a worthy consideration, it is subordinate to the primary statutory objective of promoting effective consumer protection through responsible lending.

Specific comments on sections of the draft Code

This section sets out our specific comments on sections of the draft Code. This section uses the same broad section headings as the draft Code.

1. Introduction

The Code should be technology neutral, but direct interaction between lender and borrower may be required

Issue

120. The Principles and lender responsibilities contain requirements that may require direct interaction between lender and borrower. For example, the lender's inquiries may uncover information that should be discussed directly with the borrower before a credit decision is made; or a direct interaction may be the only way the lender will discover that the borrower is vulnerable.

Recommendation

121. The Code should state that in some circumstances direct interaction between lender and borrower (whether via online chat, Skype, telephone, face-to-face or otherwise) will be required in order for the lender to discharge its obligations under the Principles.

Reasons

122. We agree that the Code should be technology neutral. However, while the path to compliance may vary by channel, the nature of the obligation does not. A lender operating in an online environment will still need to comply with the same Principles as a lender that deals with a borrower face-to-face. It is not possible to read down or modify the Principles due to the limitations of various technologies or channels.

2. Obligations that apply before and throughout the agreement

References to compliance policies need to be checked and duplication removed

Issue

123. References to compliance policies are duplicated in the draft Code. As a result, it is not clear what the overarching Principle to exercise care, diligence and skill requires in addition to what is required for compliance with the lender responsibilities. For example:
124. 2.1(a) refers to a policy for approving advertising material; and 3.9(c) refers to processes that aim to ensure that all advertising material is subject to an approval process; and
125. 2.1(c) refers to a policy on when to contact and how to communicate with borrowers and guarantors, particularly borrowers in financial difficulty or in breach of their credit agreement; and 12.2 refers to policies which set out when and how a lender contacts borrowers if the borrower misses repayments and how it manages the loans of borrowers who notify the lender that they are having, or are likely to have, difficulties repaying the loan.

Recommendation

126. The list of policies at 2.1 should be checked against Guidance in other sections of the draft Code and amended to avoid duplication.

Reasons

127. This would provide clearer Guidance and more certainty for lenders.

More Guidance on the lender's other legal obligations is required

Issue

128. The draft Code does not provide sufficient Guidance on sections 9C(4)(e) and 9C(3)(f).

Recommendation

129. Guidance at 2.11 should be amended to refer to compliance policies on key requirements of the statutes referred to in sections 9C(4)(e) and 9C(3)(f), for example:
- 129.1 unfair conduct (Part 1 of the Fair Trading Act 1986);
- 129.2 uninvited direct sales;
- 129.3 unfair contract terms;

129.4 registration and membership of a dispute resolution scheme (particularly given that there have been low levels of compliance in the consumer credit industry in the past).²⁰

130. Guidance at 2.11 could also refer to compliance policies on the lender's general legal obligations, for example conflicts of interest, fraud, anti-money laundering and financial advice.

Reasons

131. A simple cross-reference to the Guidance at 2.1-2.3 is insufficient as it does not "elaborate on" the lender's other legal obligations to the borrower. It would be of practical use to lenders and improve compliance if this section could be expanded.

²⁰ *Third-tier Lender Desk-based Survey 2011*, Ministry of Consumer Affairs, July 2011, at paragraph 66 estimated that about 35% of the third-tier lenders identified were not registered.

3. Advertising

132. The Guidance in section 3 will go some way towards improving the quality of credit advertising, but should go further. The Code should reflect the new, high standards expected of responsible lenders when advertising credit and the role advertising plays in the borrower's decision to enter into a credit agreement.

We support Guidance on fee disclosure in advertisements that refer to an interest rate

Issue

133. We support Guidance in the draft Code to the effect that, when referring to an interest rate or an amount of interest, the advertisement should state whether fees apply, and, if so, provide details about the specific upfront fees.²¹

Recommendation

134. Retain Guidance at 3.4(b).

Reasons

135. We do not think that the Guidance in section 3 or our recommendation at paragraph 104 in relation to the disclosure of annual interest rates in advertisements will result in consumers being provided with too much information. While additional disclosures will be required, this is not onerous when balanced against the clear consumer benefit.

Advertisements for credit sales should always disclose the total amount payable

Issue

136. Some advertisements for credit sales do not disclose the total amount payable. Consumers do not know the total cost of the goods promoted before contacting (or being contacted by) the lender.

Recommendation

137. Retain Guidance in the draft Code that states that when referring to the amount of regular repayments, a lender should include the total amount payable under the agreement.²²

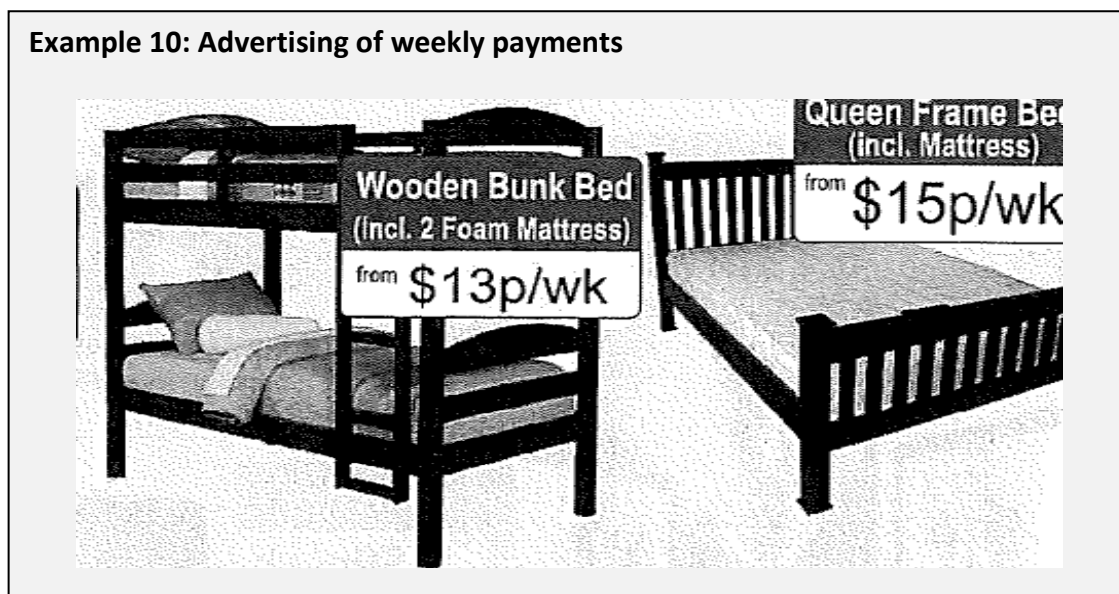
Reasons

138. This Guidance will help protect consumers who rely on catalogues and flyers for information about the goods they purchase. These are often distributed door to door. For many of these credit sale agreements, the cost of the goods is dependent on the weekly amount payable, and the number of weeks. Often, this information is not provided in the advertising, which means that consumers do not understand upfront the total cost of the goods they purchase and cannot make an informed decision.

²¹ At 3.4(b)(ii).

²² At 3.4(c)

139. For the example below, the total cost of the goods advertised is not disclosed. This would be addressed by the Guidance at 3.4(c) of the draft Code.



All high-cost short-term agreements should carry a warning

Issue

140. High-cost short-term credit is often accessed by vulnerable borrowers that require additional protection.

Recommendation

141. Retain Guidance in the draft Code that requires all advertising of high-cost short-term credit agreements to carry a risk warning.²³
142. Amend the draft risk warning²⁴ as follows:

This product is a high-cost short-term credit agreement. This product should not be used for long-term borrowing as it is suitable only to improve short-term cash flows.

Reasons

143. High-cost short-term credit agreements are an expensive way to access credit, and often apply high rates of default interest and fees relative to the amount of the loan. As such, they will only meet the borrower's requirements and objectives in limited circumstances. As these agreements are often accessed by vulnerable borrowers, this needs to be explicitly stated in advertising.
144. Our proposed amendments to the risk warning make it clear that the product being promoted is high-cost short-term credit. They will help consumers make the link between the product and the relevance of the warning.

²³ At 3.7(a).

²⁴ At 3.7(a).

The Code should incorporate the principles in *Godfrey Hirst*

Issue

145. The draft Code does not sufficiently reflect the Court of Appeal decision in *Godfrey Hirst NZ Limited v Cavalier Bremworth Limited (Godfrey Hirst)*.²⁵

Recommendation

146. Amend section 3 (in particular 3.2(b), 3.3 and 7.21(b)) to incorporate the principles from *Godfrey Hirst* that will guide a court when considering whether headline representations breach the Fair Trading Act 1986.²⁶

Reasons

147. This amendment would ensure consistency and provide useful Guidance for lenders.

²⁵ *Godfrey Hirst NZ Limited v Cavalier Bremworth Limited* [2014] NZCA 418.

²⁶ *Godfrey Hirst* at [59].

4. Inquiries into and assessment of borrower's requirements and objectives

Multiple choice questions may not always be sufficient

Issue

148. Answers to multiple choice questions will not always provide the information a lender needs to be satisfied that it is likely that the credit or finance provided under the agreement will meet the borrower's requirements and objectives.

Recommendation

149. The Code should contain Guidance on the use of multiple choice questions and examples of circumstances in which they should be used in conjunction with free-text answer fields or direct communication with the lender.

Reasons

150. We advise caution on multiple choice questions as they may fail to uncover critical information. For example, multiple choice questions may not tell the lender that the borrower has characteristics that make them vulnerable, and that the lender needs to do more to satisfy this lender responsibility.
151. The example on page 17 of the draft Code states that one way a lender could inquire into the timeframe for which credit is sought is by including a question in its application form asking the term of the loan that the borrower is seeking, along with multiple choice options. Some of the other inquiries at 4.1 (or the purpose for which the credit is sought) are not as easily translated into multiple choice questions, and a list of set answers may not always fit a prospective borrower's circumstances.

References to "pre-approved offers of credit" should be references to "conditionally pre-approved offers of credit"

Issue

152. The draft Code refers to "pre-approved offers of credit" (i.e. unconditional offers of credit) in certain places where we think that it actually means "conditionally pre-approved offers of credit".²⁷
153. For example, 4.8 relates to an offer followed by reasonable inquiries at a later date. It follows that the offer of credit is subject to the lender receiving satisfactory answers to its inquiries so that it can discharge its obligations under the Principles, i.e. that the offer of credit is "conditionally pre-approved".

Recommendation

154. References to "pre-approved offers of credit" should be reviewed and, where applicable, replaced with references to "conditionally pre-approved offers of credit."

²⁷

At 4.8 and 5.9.

155. References to “pre-approved offers of credit to existing customers” should be replaced with references to “conditionally pre-approved offers of credit to existing customers”.

Reasons

156. The Code should not imply that a lender can make an unconditional offer of credit without first discharging its obligations under the Principles.
157. References to “pre-approved offers of credit” are also at odds with Guidance at 3.5(b), which states that a lender should not make claims that suggest that the lender will not inquire into the borrower’s circumstances in making a lending decision.

5. Inquiries into and assessment of substantial hardship (borrowers)

Lenders should make more inquiries about the borrower's financial position

Issue

158. A lender making only the inquiries at 5.2 may not obtain sufficient information so as to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship.

Recommendation

159. The list of inquiries at 5.2 should be expanded to include more detailed inquiries about the borrower's financial position. For example, some of the inquiries from ASIC Regulatory Guide 209 may be appropriate in certain circumstances, for example geographical factors, such as remoteness, which may require consideration of specific issues (such as potentially higher living costs compared to urban areas).²⁸

Reasons

160. These additional inquiries may elicit information relevant to the lender's assessment, and in particular whether there is a reasonable buffer between the borrower's income and expenditure and repayments on the proposed loan.

The lender should always contact the borrower directly

Issue

161. Guidance at 5.3 is expressed in the alternative, and (notwithstanding the caveat in the last sentence) suggests that it may be sufficient for a lender to make all of its inquiries into substantial hardship without any reference to the borrower.

Recommendation

162. A lender should **always** make inquiries directly with the borrower, even if only to ascertain that there has been no change in the borrower's circumstances.

Reasons

163. It will be difficult for a lender to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship if it has not made inquiries directly with the borrower.
164. This recommendation is consistent with 5.16(f), which refers to the lender checking that there have been no significant changes to the borrower's circumstances if a "significant amount of time has passed." This implies that an initial check, directly with the borrower, is required.

²⁸ RG 209.33(g).

If a definition of “substantial hardship” is included, we prefer option 2

Issue

165. The definition of “substantial hardship” should describe a reasonable standard of living with an appropriate “buffer”.

Recommendation

166. If a definition of “substantial hardship” is included, “option 2” seems preferable.

Reasons

167. Option 2 is more closely mirrors the definition of “sustainable” at 5.3.1(6) of the UK Financial Conduct Authority’s Consumer Credit Sourcebook (CONC).
168. Option 2 refers to the borrower making repayments while meeting other “reasonable commitments”. This describes a more reasonable standard of living than option 1; and a standard we think is more consistent with “responsible” and sustainable lending practices. Option 1 describes a “pared-back” lifestyle confined to the “fundamental necessities”, with less of a buffer for emergencies or unexpected expenses.
169. Option 2 refers to the borrower making repayments “without having to borrow, and do so out of income and savings without having to realise security or assets which the borrower does not intend to dispose of”. In this regard option 2 is preferable to option 1, which is silent as to the lengths a borrower could reasonably be expected to go to in order to make the payments under the agreement.
170. Option 2 is more consistent with the list of inquiries at 5.2, which refers to regular expenditure that the borrower intends to make, such as child care, tithing and insurance premiums. This list of inquiries will also provide context for the final definition of “substantial hardship” included in the Code.

More Guidance required for high-cost short-term credit agreements

Issue

171. High-cost short-term credit is often accessed by vulnerable borrowers who are unable to access mainstream credit. These borrowers may be sufficiently desperate to omit key information (for example, pre-existing debts) or overstate income in order to obtain credit.

Recommendation

172. The Code should say that it would not be reasonable for a lender to rely on unsupported borrower declarations in relation to high-cost short-term credit agreements. This should apply regardless of whether the lender is “on notice” that the borrower may not be reliable.
173. Borrower declarations should always be supported by evidence provided by the borrower from a Government source (for example the Inland Revenue or Work and Income) or a reliable third-party source (for example bank statements or payslips).

Reasons

174. This recommendation reflects that what might be “reasonable” in relation to a regular credit agreement may not be “reasonable” in relation to a high-cost short-term credit agreement.

6. Inquiries into and assessment of substantial hardship (guarantors)

175. Many of our comments above on section 5 of the draft Code are equally applicable to section 6.

Guarantors should be vetted with as much care and diligence as borrowers

Issue

176. The draft Code requires fewer inquiries of the guarantor than the borrower in relation to substantial hardship.

Recommendation

177. The draft Code should be amended to ensure that guarantors receive the same level of care and protection as borrowers. For example:

- 177.1 Guidance at 6.5(a) should mirror 5.5(a), for example:

a guarantee where the consequences for the guarantor of not being able to make a payment when the guarantee is called on are ~~serious~~high, such as potential loss of ~~an significant-asset~~ of the guarantor or where default interest plus default fees are high relative to the amount of the loan or the credit limit:

- 177.2 Guidance at 6.5 for guarantors should include an equivalent to 5.5(c) for borrowers, for example, where the guarantor would be a new customer of the lender or is acting as a guarantor for the first time.

Reasons

178. The guarantor may be required to step into the borrower's shoes, and should be vetted with as much care and diligence at the outset as the borrower.

7. Assisting borrowers to make an informed decision

The list of key features should be expanded

Issue

179. Key features are missing from the list in the Guidance at 7.2.

Recommendation

180. The list of key features in the Guidance at 7.2 should be expanded to include:

- 180.1 the total amount payable under the credit agreement and what this comprises, including the total amount of interest payable (if ascertainable);
- 180.2 when payments are due under the credit agreement, and how payments can be made;
- 180.3 that the borrower should contact the lender if they encounter problems or potential repayment difficulties;
- 180.4 the lender's contact details.

Reasons

181. This is important information that a prospective borrower needs in order to make an informed decision.

A higher standard should be set in circumstances when the lender should "do more"

Issue

182. The level of assistance a lender is expected to provide to a vulnerable borrower is too low.

Recommendation

183. Guidance at 7.10 (and equivalent wording at 7.11 and 9.16) should be extended as follows:

- 7.10 For borrowers that should be provided with a greater level of assistance based on the factors set out at 7.7 and 7.8, lenders should provide a level of assistance such that a person with no experience in credit agreements of that type or who lacks basic knowledge about financial matters can readily understand the implications of the agreement.

Reasons

184. This Guidance applies where the lender is **on notice** that it must provide greater or further assistance when informing the borrower of the key features of the agreement, for example because the borrower does not appear to have understood the information being provided. This justifies a higher standard of care than that described at 7.10.

The interest rate that applies after a promotional period should be clearly communicated

Issue

185. Credit products are often advertised at a discounted interest rate, which applies for a limited time only. The fact that the rate is introductory only, and the amount of any subsequent higher rate, are sometimes obscure.

Recommendation

186. Guidance at 7.21(i)(ii) should be amended to incorporate some of the safeguards in 3.4(e)(ii), for example:
- ii. where the subsequent annual interest rate is not ascertainable, the fact that a higher annual interest rate will apply, how the subsequent rate will be calculated, and an indication of what the range will be.

Reasons

187. This helps ensure that a subsequent rate is clearly communicated in a meaningful way. It will be particularly helpful for borrowers with low levels of financial literacy.

Specific Guidance required for high-cost short-term credit agreements

Issue

188. Section 7 does not include sufficient Guidance on what a lender must do to assist the borrower to reach an informed decision as to whether or not to enter into a high-cost short-term credit agreement and to be reasonably aware of the full implications of entering into a high-cost short-term credit agreement.

Recommendation

189. Section 7 should include more Guidance on high-cost short-term credit agreements. In particular, Guidance should provide that despite 7.8, greater or further assistance should be provided when informing the borrower of the key features for high-cost short-term credit.

Reasons

190. Other sections of the draft Code include specific Guidance for high-cost short-term credit agreements. This should be replicated in section 7 due to the high risk nature of these products and the vulnerable borrowers they attract.

More Guidance required on plain language

Issue

191. The draft Code does not include sufficient Guidance on the lender responsibility to ensure that the terms of the agreement are expressed in plain language in a clear, concise and intelligible manner.

Recommendation

192. Guidance at 7.17 to 7.19 should be expanded.

Reasons

193. The requirement that agreements are expressed in plain language in a clear, concise and intelligible manner is critical to the ability of a borrower to make an informed decision. If an agreement is not easy for the intended reader to read, understand and recall it will be difficult for the borrower to make an informed decision and for the lender to discharge its obligations under the Principles.
194. There is a significant amount of guidance already available in relation to plain language, plain English and Easy Read information. It would be helpful for lenders if a fuller explanation of the relevant drafting principles were included in the Code.
195. Plain language experts may be able to assist MBIE to draft further Guidance if required.

8. Assisting guarantors to make an informed decision

196. Many of our comments above on section 7 of the draft Code are equally applicable to section 8. For example, our recommendations at paragraphs 53 to 60 in relation to the definition of “experienced user of credit” will be relevant at 8.11(d) to a guarantor who is an experienced user of credit.

Amend the “previous guarantor” category

Issue

197. The fact that a guarantor “has previously had a relationship with the lender and has given a similar guarantee before” is an unsound basis for providing a lower level of assistance when informing the guarantor of the key features of the guarantee, and is likely to capture guarantors who experience problematic lending.

Recommendation

198. Guidance at 8.11(b) should be re-drafted as follows:

a guarantor who has previously had a relationship with the lender and who has previously given a similar guarantee before in relation to the same credit product provided by that lender, without encountering any problems or repayment difficulties;

Reasons

199. Many of our comments on the “existing customer” category at paragraphs 45 to 51 are also relevant to the reference to “previous guarantors” at 8.11(b). A guarantor may be required to step into the borrower’s shoes, and should receive the same assistance as the borrower.

9. Credit-related insurance and repayment waivers

Extended warranties

Issue

200. The Code provides Guidance on credit-related insurance and repayment waivers, but provides no Guidance on extended warranties. The responsible lending provisions in the CCCFA clearly apply to extended warranties irrespective of the Code, and the fact that the Code has no Guidance on responsible lending and extended warranties is not helpful for lenders, borrowers or the Commission.

Recommendation

201. Section 9 of the Code should deal with extended warranties in the same way as it currently deals with repayment waivers (i.e. like 9.1). Paragraph 7.24 should be deleted.

Reasons

202. The CCCFA refers to extended warranties that are provided by creditors in relation to goods that are being financed. Extended warranties are functionally similar to credit-related insurance, and they are treated similarly to credit-related insurance and repayment waivers. Section 9B(4) says repayment waivers and extended warranties are to be treated as forming part of the credit agreement for the purposes of responsible lending, but the Code does not deal effectively with extended warranties.
203. Extended warranties are referred to in 7.24, but that Guidance is essentially a cross reference to the treatment of extended warranties under the Fair Trading Act. The Fair Trading Act includes tailored disclosure rules, and a cancellation right. However, the cancellation right does not apply to extended warranties entered into as a condition of a consumer credit contract (section 36V). And the disclosure obligations fall short of the lender being required to make the inquiries or provide the assistance required for responsible lending.

More Guidance on the relative cost of credit-related insurance for high-cost short-term credit agreements

Issue

204. Guidance at 9.5 that a lender “should consider” the relative cost of credit-related insurance does not provide enough protection for borrowers and is not as helpful as it could be for lenders.

Recommendation

205. The Code should provide more definitive Guidance on what a responsible lender is expected to do (or not do) when considering the relative cost of credit-related insurance for high-cost short-term credit agreements.

Reasons

206. Insurance premiums can add substantially to the amount of some loans. It is important that the Code provides clear Guidance to assist lenders when considering whether credit-related insurance will meet the borrower's requirements and objectives.

Responsible lending obligations*Issue*

207. The general issues concerning the level of inquiries and assistance necessary for the lender to meet its responsibilities apply to credit-related insurance, repayment waivers and extended warranties. Section 9 of the draft Code refers to factors giving rise to variable levels of assistance for borrowers to reach informed decisions (9.13 – 9.15). Any amendments made to the other sections of the draft Code covering the level of assistance for different borrowers should also be reflected in 9.13 – 9.15.
208. We assume the lack of a similar discussion in relation to the level of lender inquiries necessary to comply with the Principles is deliberate. This means the obligation of lenders to make inquiries to be satisfied that the credit-related insurance meets the requirements and objectives of the borrower will be the same for all loans.

Recommendation

209. Paragraphs 9.13 – 9.15 should be amended to be consistent with any amendments to the other lender assistance paragraphs in the Code (including any amendments made to 7.11 responding to the issue about whether a borrower can be reasonably aware of the full implications of the transaction where there may be no oral interaction between the lender and the borrower).

Reasons

210. The general comments made by the Commission regarding the level of assistance necessary for the lender to comply with the Principles also apply to the level of lender assistance in 9.13 – 9.15.
211. This submission already discusses the desirability of direct interaction between lender and borrower in certain circumstances, and these issues are likely to also be relevant for credit-related insurance and similar transactions.²⁹

²⁹ At paragraphs 120 to 122.

10. Fees

212. The Code does not provide Guidance on the specific cost categories that may or may not be recovered under the CCCFA. The Commission’s own draft guidelines do refer to specific cost categories, and we envisage that the Commission will continue to publish its own fee guidelines (based on current case law as it evolves) if similar detail is not included in the Code. For example, the Commission remains of the view that costs of capital are not a genuine accounting cost of the type that is recoverable through credit fees.

Evidence of compliance

Issue

213. There is a potential problem for lenders that may attempt to rely on section 44B of the CCCFA which says that evidence of a lender’s compliance with the Code is to be treated as evidence that a credit fee or default fee is not unreasonable. Section 44B (like section 9E(3)) does not say compliance with the Code is *conclusive* evidence of compliance with the underlying legal obligations of lenders. The Commission could potentially take enforcement action against a lender that complies with the general provisions of the Code, but may still be setting an unreasonable fee.
214. An area of uncertainty is where the Guidance refers to lenders taking into account “past experience” in assessing reasonable costs in relation to establishment fees (10.1(a)), credit fees (10.3(a)) and default fees (10.5(c)).

Recommendation

215. Section 44B of the CCCFA (and its limitations) should at least be referred to in the Commentary in section 10 of the Code. The words used in the Commentary regarding section 9E(3) on page 3 could be adapted for the fees Commentary on page 48.
216. References to “past experience” in setting fees in section 10 of the Code should be replaced with:

The lender’s assessment of the costs that justify its fees should be based on actual and reasonable costs incurred over a particular period and likely to be incurred in the future, relevant to the relevant class of consumer credit contracts, and measured using accepted accounting practices.

Reasons

217. The CCCFA says that compliance with the Code will be evidence that fees are not unreasonable. Therefore the Code needs to provide clear Guidance on how to comply with the Principles in relation to fees. Section 10 is not as clear as it could be and may result in lenders setting a fee that could comply with the Principles but still be unreasonable.
218. It is obvious that lenders will have to make an estimate of their costs in setting the different types of fees on a cost recovery basis. However the Commission is

concerned that simply referring to “past experience” is too loose, and potentially open-ended.

219. The lender will also be required to determine if and how the costs are relevant to the particular fee, and there will inevitably be issues as to which proportions of the costs are allocated to particular fees (or not). These decisions will also need to be made and justified using accepted accounting practices. Simply referring to “past experience” does not reflect the complexity of the decision-making processes lenders will be expected to undertake. The draft Code does not provide certainty for lenders, borrowers or the Commission in relation to the calculation of credit fees or default fees.

Prepayment fees

Issue

220. There are two types of prepayment fees under section 43 – prepayment fees on the full prepayment of a fixed rate loan, and prepayment fees on a part prepayment. The Code does not reflect this distinction, and 10.2(a) implies that the formula in the CCCF Regulations may be relevant to fees on a part prepayment. This is incorrect. The general principle in 10.2(b) applies to full and part prepayment fees, but the formula in the regulations only applies to full prepayments.

Recommendation

221. Paragraphs 10.2(a) and (b) should be re-ordered, and the reference to the Regulations should be limited to full prepayments.

Insurance premiums

Issue

222. Paragraph 10.4 refers to credit fees that are insurance premiums, and says “the lender may also recover the costs that reflect the risks insured against.” It is unclear what these words mean. Presumably insurance premiums will always reflect the risks insured against, to a greater or lesser extent.

Recommendation

223. Paragraph 10.4 should say the *insurance premiums* that the lender may recover through a credit fee should reflect the risks insured against, rather than the amount of the fee being related to the risk.

Default fees

Issue

224. The Code refers to the creditor taking steps to mitigate the losses it recovers through default fees, but the Code does not provide any Guidance on how a creditor might be expected to mitigate those losses.

Recommendation

225. The Code should provide Guidance on lenders mitigating their losses on default. For example, default losses could be mitigated through timely debt management and, if necessary, enforcement action.

Reasonable standards of commercial practice*Issue*

226. The words used in the Code in relation to reasonable standards of commercial practice accurately reflect the provisions of the CCCFA. We agree that reasonable standards of commercial practice should not be used as a justification for over-recovering costs, or increasing fees. We also agree that reasonable standards of commercial practice are subordinate to the underlying cost recovery principle.
227. However, the Code does not provide any Guidance on what reasonable standards of commercial practice means (apart from the fact that a common standard is not necessarily a reasonable standard).

Recommendation

228. The Code should say that the reasonable standards of commercial practice test applies to whether the costs the lender is seeking to recover through the fees are excessive, as well as the methodologies for quantifying and allocating those costs.

The name of the fee should reflect the matter giving rise to the fee*Recommendation*

229. The Code should include Guidance to the effect that the name of a fee should reflect the matter giving rise to the fee. For example, a letter fee should not be used to fund the lender's marketing costs. It should reflect the cost to the lender of sending a letter to the borrower.

Reason

230. This would promote informed decisions and be consistent with the updated purposes of the CCCFA.

11. Subsequent dealings

Advertising

Issue

231. Section 11 of the draft Code focuses on communications between lenders and borrowers, and variations to loan agreements during the term of the loan. Paragraph 11.1 refers to the general obligation of lenders not to provide information that is misleading, deceptive or confusing, and cross references 7.20 – 7.23. However the information covered by this section of the Code does not include advertising, and 7.22 and 7.23 deal with advertising.

Recommendation

232. Paragraphs 7.22 and 7.23 should be omitted from the cross references in 11.1.

Objectives and requirements of variations

Issue

233. Paragraph 11.8 says a responsible lender will consider whether the original assessment that the borrower can make the payments without suffering substantial hardship remains valid when it considers variations where the lender will advance further credit to the borrower. This is obviously appropriate, but it only covers off one of the issues on which the lender needed to make inquiries to be reasonably satisfied when the loan was originally entered into. The other issue which a responsible lender should consider is whether the lender should make further inquiries to be satisfied that the variation meets the objectives and requirements of the borrower.

Recommendation

234. Paragraph 11.8 should also refer to the lender's assessment of whether the credit met the borrower's requirements and objectives at the beginning of the agreement remains valid.

Reasons

235. A lender which only considers the substantial hardship issue referred to in 11.8, without also considering the objectives and requirements of the borrower, will be potentially breaching the Principles. This will be an important inquiry, especially where the lender is offering further credit or to increase a credit limit where the borrower has not applied for the increase.

Variations and exercise of lenders powers

Issue

236. Paragraphs 11.7 and 11.9 make it clear that the Guidance only applies to variations which are agreed between the lender and the borrower, and 11.9 specifically says it does not apply to variations made by the lender exercising a power under the agreement. The CCCFA provides for situations where the lender unilaterally varies

an agreement (e.g. by changing a variable interest rate), and lenders are required to make variation disclosure in those circumstances (section 23).

Recommendation

237. Guidance at 11.7 and 11.9 should apply to variations arising from the exercise of a lender's power.

Reasons

238. Lenders are still required to be responsible lenders when they exercise this type of variation power. For example, a lender should consider what information it has about whether the borrower can make the payments under the agreement without suffering substantial hardship, and whether that responsible lending test will still be met following the exercise of a unilateral power.
239. The legal obligation to comply with the Principles will exist in any event, and the omission in the Code will potentially mislead lenders who rely on complying with the Code to meet their responsible lending obligations.

12. Default and other problems

Reasonable and ethical manner

Issue

240. One of the lender responsibilities in the CCCFA is for the lender to treat the borrower and their property “reasonably and in an ethical manner”, including when there is a breach of a loan agreement and when the borrower suffers unforeseen hardship (section 9C(3)(d)). The same lender responsibility also applies in relation to guarantors (section 9C((4)I).
241. Section 12 of the draft Code addresses these lender responsibilities, but the Guidance does not directly discuss what “reasonably and in an ethical manner” means in this context. There is an inference that specific practices a lender should not undertake under 12.1 are not reasonable or ethical, and the positive communication Guidance in 12.2 – 12.9 shows what would be reasonable and ethical. However the Code does not frame the discussion of these issues in terms of reasonable and ethical conduct by lenders.

Recommendation

242. The Code should provide more Guidance on what lenders treating borrowers reasonably and in an ethical manner means. The Code could refer to lenders treating borrowers honestly and fairly, not using threats or intimidation to extract payment from borrowers in default, and not making decisions that are prejudicial to borrowers based on ulterior motives.

Reasons

243. The Code as drafted leaves it for the Commission in the first instance, and ultimately the Courts, to form a view on what it means for lenders to treat borrowers reasonably and ethically. The Code will provide relevant context on the kinds of conduct that might be expected (or not expected) from a responsible lender, but there is no direct Guidance. The only reference to the reasonable and ethical test (apart from being recited in the Principles) is the example after 12.8, and it says that publicly shaming borrowers who default by publishing their photo in local newspapers “may be an indication that the lender is not treating the borrower reasonably and in an ethical manner.” The fact that this is not a definitive statement (despite the practice being an obvious breach of the Privacy Act, and clearly unreasonable) adds uncertainty rather than certainty to the meaning of the lender responsibility.

Securities

Issue

244. The language used in section 12 about securities is not technically correct (e.g. “exercising its right to the security given by the borrower” in the Commentary, “realise any gain from selling the loan security” in 12.5, and the second example after 12.7 referring to a borrower selling a car that is subject to a security interest).

245. In this context, a security interest is a right to repossess or sell personal property (or land, in the case of a mortgage of land). The “security” is the document creating the security interest, and property is given “as security” for the debt. A secured lender’s primary right is therefore the right to sell the secured property, rather than the security itself. The idea that the lender might “realise any gain” from the sale of the secured property under 12.5 is probably not realistic. An additional issue with 12.5 is that it overlooks the borrower’s new right to deliver secured property to the lender after a repossession warning notice is issued (section 83H).
246. The second example after 12.7 is also artificial. The effects of a security interest over a car or other assets include the borrower not being able to pass clear title on to a purchaser. The only way the borrower can sell the asset is if the lender releases its security interest, and it will generally only do that if the proceeds are used to repay the loan. If the borrower offers to repay the debt in full, the lender has no option but to accept the repayment (including any fees that are likely to accrue) and discharge the security. The example suggests this is a decision for the lender to make, which is not the case.

Recommendation

247. The references to securities and security interests and the examples in section 12 should be checked and edited for technical accuracy.
248. Section 12 should also refer to the borrower’s right to deliver secured property to the lender if a repossession warning notice is issued.

Guarantors

Issue

249. Section 12 of the draft Code refers to the lender responsibility to treat guarantors reasonably and ethically. Guarantors are referred to in the Commentary, but the only references to guarantors in the actual Guidance relate to taking new guarantees after a default, and holding guarantors’ personal documents (12.1(e) and (f)). There are no references to lenders pursuing their remedies against borrowers before pursuing guarantors. And there is no Guidance on when and how guarantors should be informed if the borrower is having difficulty repaying a loan.

Recommendation

250. Section 12 should provide for the same protections for guarantors and borrowers when there is a default, or the borrower is having difficulty meeting their obligations.

Reasons

251. Guarantors are vulnerable when loans go into default, but the Code is silent in this regard. The Code provides no Guidance for lenders, the Commission or guarantors themselves as to what the responsible lending duties of lenders will be in practice.

Unforeseen hardship applications

Issues

252. There are gaps in the unforeseen hardship application Guidance. For example, lenders have a discretion to allow borrowers to make repeat unforeseen hardship applications within four months (section 55(1B)), and the Code could usefully provide Guidance on what might be expected from a responsible lender in these circumstances. The Commentary on page 58 refers to the lender not being able to take repossession enforcement action while deciding on an unforeseen hardship application, but this point is not picked up in the Guidance. The prohibition on enforcement action under section 83J also applies if there is an unresolved complaint, which should also be referred to at 12.17-12.18.
253. The criteria for lenders considering unforeseen hardship applications include a reference to substantial hardship (12.11(b) and 12.14(b)). Presumably this term will have the same meaning as in section 5 of the draft Code, but it would be useful if the cross reference was explicit.
254. We note that the criteria for lenders considering unforeseen hardship applications in 12.11(c) and (d) are repetitive – both refer to the borrower meeting their obligations during the period of unforeseen hardship. The same duplication also appears in 12.14(c) and (d). The paragraphs should refer to the borrower meeting its obligations under the proposed repayment plan. The point of the unforeseen hardship application is that the borrower cannot meet the obligations under the loan agreement, so it needs to be varied.

Recommendation

255. The gaps and drafting issues we have identified above in relation to unforeseen hardship applications should be addressed in the Code.

Enforcement rights

256. The enforcement right provisions in 12.15 and 12.16 could usefully adopt some of the language used in relation to repossession in section 13 of the draft Code. In particular, 12.15(c) should refer to lenders not intimidating borrowers, which is the wording used in 13.3. Paragraph 12.16 should also follow the approach in 13.6, and say “To comply with the above lender responsibilities, a lender should ...”

13. Repossession

Issue

257. Many of the obligations in Part 3A are relatively prescriptive (particularly repossessions from residential premises), and there is little value in repeating the provisions from the primary legislation in the Code. However, there are some significant gaps in this section of the Code which could usefully be addressed.

Recommendations

258. The heading should be amended to *After the repossession warning notice has been issued*. The Guidance given in 13.9 says it applies during the repossession process, but it actually applies to the borrower's right to return goods after a repossession warning notice has been issued.
259. 13.12(a) should be deleted as the security over goods that are sold will be released automatically as a matter of law (section 83ZG).
260. This section of the Code could usefully provide Guidance on how lenders can comply with their obligation to specifically identify goods in their security agreements (under section 83F). We understand some creditors use photographs, and that (in conjunction with names and serial numbers of particular consumer goods) is a practice that could be encouraged. Further, the Amendment Act is less prescriptive about repossessions from commercial premises or from public places, and it may be appropriate to provide Guidance on these types of repossessions.
261. This section of the Code should refer to section 83Q of the CCCFA which says a creditor must act in accordance with the lender responsibility principles when actually exercising a right to enter premises.
262. In practice, an area which is relatively clear legally, but which is nevertheless controversial, is the limit on lenders' right to recover ongoing interest, fees and costs after consumer goods are sold as part of a repossession process (section 83ZM). This is a provision that is often overlooked or misunderstood, and covering it in the Code would be helpful. In particular, Guidance could be given on the implications if not all the goods under a security agreement are repossessed or sold.
263. The "examples" on page 68 actually read like extra Guidance rather than examples. It would be a pity to lose the points by deleting them as examples; we would prefer them to be incorporated in the general Guidance. There is also considerable case law on the issue of obtaining best price, and some of this could be summarised to provide useful Guidance.

Reasonable and ethical manner

Issue

264. The lender responsibility to treat the borrower and their property "reasonably and in an ethical manner" applies to repossession as well as on a breach of a loan agreement and when the borrower suffers unforeseen hardship (section 9C(3)(d)).

Similarly to section 12 of the Code, section 13 addresses these lender responsibilities without providing direct Guidance on what “reasonably and in an ethical manner” means in relation to repossession. The Guidance about what is expected (or not) from lenders and their agents provides context and inferences on what might be reasonable or ethical from a lender, but the Code provides little direct Guidance for lenders, the Commission or the Courts on what the lender responsibility will mean.

Recommendation

265. As with section 12 of the Code, the opportunity should be taken for the Code to be more prescriptive about what is expected from lenders when they treat borrowers reasonably and ethically.

Right to deliver secured property

266. The discussion in 13.1 about lenders agreeing to repossess goods where requested to do so by the borrower should acknowledge the borrower’s new right to deliver secured property to the lender after a repossession warning notice is issued (section 83H). This could affect the first example on page 64. Note that the second example is exactly the same as the second example after 12.7. It does not seem to be ideal to repeat examples in different chapters of the Code. Apart from that point, our comments in relation to the example in section 12 of the Code apply equally to the example in section 13.

14. Oppression

267. The process Guidance in this section is helpful. The structure following the three elements of potential oppression is appropriate (i.e. inducement to enter into the agreement, the terms of the agreement and the exercise of the lender's power).
268. The Commission agrees that responsible lenders should consider their standard form agreements against its unfair contract terms guidelines. The Ministry should however be aware that the bar for the oppression test is higher than the bar for unfair contract terms. An unfair contract term will not necessarily be oppressive in terms of the CCCFA.

Issue

269. Guidance at 14.3 refers to the Guidance in the Code regarding assisting borrowers and guarantors to make informed decisions in the context of lenders potentially exercising their powers in an oppressive manner. This is incomplete; lenders are more likely to exercise their powers in an oppressive manner in the context of their subsequent dealings with borrowers, or in default or repossession situations.

Recommendation

270. Guidance at 14.3 should be broadened to refer to the full range of relevant Guidance in the Code.

Attachment A: Summary of recommendations

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|---|------------------------|
| Key recommendations | | |
| The Code should emphasise that the lender’s primary obligation is to comply with the Principles. Suggested revisions to the Guidance at section 4 are in Attachment C. | Throughout the Code | 18-20 |
| Suggested revisions in Attachment C are also applicable to other Guidance that refers to lenders exercising judgement or taking steps that could be regarded as falling short of the requirements of the Principles in certain circumstances. | In particular s5 (5.6), s6 (6.6, 6.7), s7 (7.8), s8 (8.11) and s9 (9.14). | 19 |
| Suggested revisions in Attachment C also reflect our recommendations in relation to the “light touch” categories. | 4.3(a), 4.3(b), 4.3(c), 5.6, 6.6, 7.8(a), 7.8(b), 7.8(d), 8.11(d) and 9.14. | 20 |
| Primary recommendation: replace the “light touch” categories with a list of factors a lender can take into account when deciding what additional inquiries to make and what higher level of assistance to provide in circumstances in which the lender should “do more”. | As above. | 31 |
| Alternative recommendation: The “simple credit agreement” category should be replaced with an equivalent to 4.2(c) and 7.7(c), i.e. a credit agreement where the loan amount is small relative to the borrower’s ability to | 4.3(a) and | 43 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|-----------------------------------|------------------------|
| repay. | 7.8(a) | |
| Alternative recommendation: Re-draft the “existing customer” category. | 4.3(b), 5.6, 6.6, 7.8(b) and 9.14 | 46 |
| Alternative recommendation: Re-draft the definition of “experienced user of credit”. | Glossary | 55 |
| Include a new definition of “vulnerable customer”. | Glossary | 56 |
| The Code should require a lender to consider: whether it has other suitable products or product features that could reduce the cost of borrowing and meet the borrower’s needs; and the purpose for which the credit is sought. | Section 4 | 62 |
| The draft Code should include specific Guidance on unsuitability and examples of unsuitable products that will not meet the borrower’s requirements and objectives in certain circumstances. | Section 4 | 77 |
| The definition of “high-cost short-term credit” should be amended. | Glossary | 80 |
| Include a new definition of “continuing credit agreement”. | Glossary | 81 |
| Include commentary in the Introduction to the effect that references to compliance policies in the Code are references to compliance policies that contain content that would, if followed, achieve compliance with the Principles. | Section 1 | 93 |
| Make it clear that simply having a policy will not evidence compliance with the Principles unless that policy contains content that would, if followed, achieve compliance with the Principles; is fully embedded in the lender’s business; is followed by the lender and its representatives and agents; and is reviewed and amended as | 2.3 – 2.5 | 94 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|-------------------------------------|------------------------|
| required. | | |
| References to compliance policies should be reviewed and strengthened to emphasise substance over form, and make it clear that the content of a compliance policy must achieve the objectives of the Principles. | Throughout the Code | 95 |
| It is not enough to simply record that a good compliance policy has been followed. | 2.9(a), 4.10(c)(i) 5.16(c)(i) | 99 |
| The Code should require an annual interest rate (and a note if that rate is variable) to be disclosed in every credit advertisement. | Section 3 | 104 |
| All assessments should be objective and apply genuinely reasonable standards of care. | 7.13 and 7.15 | 110-112 |
| The Ministry should focus on compliance costs that are evidenced by lenders, clearly “unnecessary” and genuine increased costs of doing business. | N/A | 117 |
| 1. Introduction | | |
| The Code should state that in some circumstances direct interaction between lender and borrower (whether via online chat, Skype, telephone, face-to-face or otherwise) will be required in order for the lender to discharge its obligations under the Principles. | Section 1 | 121 |
| 2. Obligations that apply before and throughout the agreement | | |
| References to compliance policies need to be checked and duplication removed | 2.1 | 126 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|-----------------------------|------------------------|
| More Guidance on the lender's other legal obligations is required | 2.11 | 129-130 |
| 3. Advertising | | |
| We support Guidance in the draft Code to the effect that, when referring to an interest rate or an amount of interest, the advertisement should state whether fees apply, and, if so, provide details about the specific upfront fees. | 3.4(b) | 134 |
| Advertisements for credit sales should always disclose the total amount payable. | 3.4(c) | 137 |
| All high-cost short term credit agreements should carry a warning. The proposed warning in the draft Code should be amended. Note also recommended amendments to definition of "high-cost short-term credit agreement" at paragraph 80 of this submission. | 3.7(a) | 141-142 |
| The Code should incorporate the principles in <i>Godfrey Hirst</i> | 3.2(b), 3.3, 7.21(b) | 146 |
| 4. Inquiries into and assessment of the borrower's requirements and objectives | | |
| The Code should contain Guidance on the use of multiple choice questions and examples of circumstances in which they should be used in conjunction with free-text answer fields or direct communication with the lender. | Section 4 | 149 |
| References to "pre-approved offers of credit" should be reviewed and, where applicable, replaced with references to "conditionally pre-approved offers of credit." | 4.8 and 5.9 | 154 |
| References to "pre-approved offers of credit to existing customers" should be replaced with references to "conditionally pre-approved offers of credit to existing customers". | Throughout the Code | 155 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|---|-----------------------------|------------------------|
| 5. Inquiries into and assessment of substantial hardship (borrowers) | | |
| The list of inquiries at 5.2 should be expanded to include more detailed inquiries about the borrower’s financial position. | 5.2 | 159 |
| A lender should always make inquiries directly with the borrower, even if only to ascertain that there has been no change in the borrower’s circumstances. | 5.3 | 162 |
| If a definition of “substantial hardship” is included, “option 2” seems preferable. | 5.1 | 166 |
| The Code should say that it would not be reasonable for a lender to rely on unsupported borrower declarations in relation to high-cost short-term credit agreements. Borrower declarations should always be supported by evidence provided by the borrower from a Government source (for example the Inland Revenue or Work and Income) or a reliable third-party source (for example bank statements or payslips). Note also recommended amendments to definition of “high-cost short-term credit agreement” at paragraph 80 of this submission. | Section 5 | 172-173 |
| 6. Inquiries into and assessment of substantial hardship (guarantors) | | |
| The draft Code should be amended to ensure that guarantors receive the same level of care and protection as borrowers. | 6.5 | 177 |
| 7. Assisting borrowers to make an informed decision | | |
| The list of key features should be expanded. | 7.2 | 180 |
| A lender should be required to provide a higher level of assistance to a vulnerable borrower than that anticipated by the draft Code. | 7.10, 7.11 and 9.16 | 183 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|-----------------------------|------------------------|
| The interest rate that applies after a promotional period should be clearly communicated. | 7.21(i)(ii) | 186 |
| Section 7 should include more Guidance on high-cost short-term credit agreements. In particular, Guidance should provide that despite 7.8, greater or further assistance should be provided when informing the borrower of the key features for high-cost short-term credit. Note also recommended amendments to definition of “high-cost short-term credit agreement” at paragraph 80 of this submission. | Section 7 | 189 |
| More Guidance is required on the lender responsibility to ensure that the terms of the agreement are expressed in plain language in a clear, concise and intelligible manner. | 7.17-7.19 | 192 |
| 8. Assisting guarantors to make an informed decision | | |
| Many of our comments on section 7 of the draft Code are equally applicable to section 8. | Section 8 | 196 |
| The “previous guarantor” category at 8.11(b) should be amended. | 8.11(b) | 198 |
| 9. Credit-related insurance and repayment waivers | | |
| Section 9 should deal with extended warranties in the same way as it currently deals with repayment waivers (i.e. like 9.1). Paragraph 7.24 should be deleted. | Section 9 and 7.24 | 201 |
| The Code should provide more definitive Guidance on what a responsible lender is expected to do (or not do) when considering the relative cost of credit-related insurance for high-cost short-term credit agreements. | 9.5 | 205 |
| Paragraphs 9.13 – 9.15 should be amended to be consistent with any amendments to the other lender assistance paragraphs in the Code. | 9.13 -9.15 | 209 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|------------------------------|------------------------|
| 10. Fees | | |
| Section 44B of the CCCFA (and its limitations) should at least be referred to in the Commentary in section 10 of the Code. The words used in the Commentary regarding section 9E(3) on page 3 could be adapted for the fees Commentary on page 48. | Section 10 | 215 |
| References to “past experience” in setting fees in section 10 should be replaced with recommended wording. | 10.1(a), 10.3(a) and 10.5(c) | 216 |
| Prepayment fees: Paragraphs 10.2(a) and (b) should be re-ordered, and the reference to the Regulations should be limited to full prepayments. | 10.2(a) and (b) | 221 |
| Insurance premiums: Paragraph 10.4 should say the <i>insurance premiums</i> that the lender may recover through a credit fee should reflect the risks insured against, rather than the amount of the fee being related to the risk. | 10.4 | 223 |
| Default fees: The Code should provide Guidance on lenders mitigating their losses on default. | Section 10 | 225 |
| The Code should say that the reasonable standards of commercial practice test applies to whether the costs the lender is seeking to recover through the fees are excessive, as well as the methodologies for quantifying and allocating those costs. | Section 10 | 228 |
| The name of the fee should reflect the matter giving rise to the fee. | Section 10 | 229 |
| 11. Subsequent dealings | | |
| Advertising: Paragraphs 7.22 and 7.23 should be omitted from the cross references in 11.1. | 11.1 | 231 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|--|-----------------------------|------------------------|
| Objectives and requirements of variations: Paragraph 11.8 should also refer to the lender's assessment of whether the credit met the borrower's requirements and objectives at the beginning of the agreement remains valid. | 11.8 | 234 |
| Guidance at 11.7 and 11.9 should apply to variations arising from the exercise of a lender's power. | 11.7 and 11.9 | 237 |
| 12. Default and other problems | | |
| The Code should provide more Guidance on what lenders treating borrowers reasonably and in an ethical manner means. | Section 12 | 242 |
| References to securities and security interests and the examples in section 12 should be checked and edited for technical accuracy. | Section 12 | 247 |
| Section 12 should also refer to the borrower's right to deliver secured property to the lender if a repossession warning notice is issued. | Section 12 | 248 |
| Section 12 should provide for the same protections for guarantors and borrowers when there is a default, or the borrower is having difficulty meeting their obligations. | Section 12 | 250 |
| The gaps and drafting issues we have identified in relation to unforeseen hardship applications should be addressed in the Code. | Section 12 | 255 |
| 13. Repossession | | |
| The heading should be amended to <i>After the repossession warning notice has been issued</i> | Section 13 | 258 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|---|-----------------------------|------------------------|
| 13.12(a) should be deleted as the security over goods that are sold will be released automatically as a matter of law (section 83ZG). | 13.12(a) | 259 |
| Section 13 could usefully provide Guidance on how lenders can comply with their obligation to specifically identify goods in their security agreements (under section 83F). We understand some creditors use photographs, and that (in conjunction with names and serial numbers of particular consumer goods) is a practice that could be encouraged. Further, the Amendment Act is less prescriptive about repossessions from commercial premises or from public places, and it may be appropriate to provide Guidance on these types of repossessions. | Section 13 | 260 |
| Section 13 should refer to section 83Q of the CCCFA which says a creditor must act in accordance with the lender responsibility principles when actually exercising a right to enter premises. | Section 13 | 261 |
| In practice, an area which is relatively clear legally, but which is nevertheless controversial, is the limit on lenders' right to recover ongoing interest, fees and costs after consumer goods are sold as part of a repossession process (section 83ZM). This is a provision that is often overlooked or misunderstood, and covering it in the Code would be helpful. In particular, Guidance could be given on the implications if not all the goods under a security agreement are repossessed or sold. | Section 13 | 262 |
| The "examples" on page 68 actually read like extra Guidance rather than examples. It would be a pity to lose the points by deleting them as examples; we would prefer them to be incorporated in the general Guidance. There is also considerable case law on the issue of obtaining best price, and some of this could be summarised to provide useful Guidance. | Examples on page 68 | 263 |
| The Code should be more prescriptive about what is expected from lenders when they treat borrowers reasonably and ethically. | Section 13 | 265 |

| Recommendation | Code (section or paragraph) | Submission (paragraph) |
|---|-----------------------------------|---------------------------|
| 14. Oppression | | |
| Guidance at 14.3 should be broadened to refer to the full range of relevant Guidance in the Code. | 14.3 | 270 |

Attachment B: Drafting comments

| Reference | Drafting comments |
|---|---|
| General | The draft Code refers to “sections” to describe its major parts, however these parts are referred to as “Chapters” in the questions included in the draft Code. We have referred to “sections” in this submission for consistency with the draft Code. |
| General | Sub-paragraphs and sub-sub-paragraph numbering (for example, “3.4e.” and “3.4e.i.”) should be bracketed (for example, “3.4(e)” and “3.4(e)(i)”) for consistency with cross-references already used in the draft Code and to assist with citing particular provisions in the Code. |
| General | <p>Check capitalisation of the word “guidance” for consistency. For example:</p> <ul style="list-style-type: none"> • “Guidance” is capitalised at 2.9 and 2.10 when referring to the Guidance provisions of the Code, and in the Commentary on page 34 when referring to the FMA’s Guidance note on “Client Communications and Record-keeping”; • “guidance” is lower case in the Commentary in the Introduction section and at 9.17 when referring to the guidance provisions of the Code. <p>We suggest that “Guidance” is capitalised and defined in the Glossary by reference to the description of Guidance on page 3. Lower case “guidance” should be used in all other cases.</p> |
| General | Check use of bold and terminology in relation to the defined term “high-cost short-term credit agreements” and amend for consistency. For example, 4.5 refers to “ high-cost short-term credit agreements ”; 5.8 and 6.9 refer to “ high-cost short-term credit agreements ”; 12.3 refers to “ high-cost short-term credit agreements ”; 3.7 and “Different products and circumstances” on page 4 refers to “high-cost short-term credit agreements” (with no bold at all); 3.7 refers to “high cost short term credit” (with no bold and no “agreement”); and 7.2(a)(v) refers to “ high-cost short-term credit ”. |
| Page 3, paragraph 3 | This paragraph confuses the discussion on the “Status of the Code”. The first sentence repeats material from the previous paragraphs, without the important qualifications in the second paragraph. The first sentence should be deleted. The second sentence (“[t]he commentary and examples do not purport...”) could either replace or be added to the sentence at the end of paragraph 2 (“ <i>Commentary and Examples – ...</i> ”). |
| 2.2(a) 3.9(a) and (b) 7.23(a) and (b) | The Guidance in these sections should be generalised to include all relevant staff, for example at 3.9(a) marketing staff and product managers should understand how to comply with relevant legal requirements as in a large organisation they would be the people putting together the advertisements. References to “relevant sales staff” should be deleted and replaced with simple references to “relevant staff”. |

| Reference | Drafting comments |
|---|---|
| 2.6(a) | Amend to make it clear that an authorised person or contact must be authorised/provided for the purpose of the contact. |
| 2.6(d) | Refer to “duly authorised” advisors. |
| 3 | Statement of principle – insert space between “(c2)(a)(i)” and “of”. |
| 3.3(b) | <p>This sub-paragraph contains two distinct subjects and should be split into two, i.e:</p> <ol style="list-style-type: none"> a. Make sure key information is legible or audible, or both. b. Take care to disclose information in a level of detail that is commensurate with its importance. |
| Commentary page 12 | <ul style="list-style-type: none"> • Insert “the” between “that” and “test” in line 3. • Insert “test” between “the” and “set out” in line 4. |
| Example page 12 | Guidance should not suggest that an advertisement should state that an establishment fee does not apply. This is unnecessary information. |
| 3.9(a) | 3.9(a) refers to staff and agents understanding how to comply with legal obligations, however there is no clear corresponding requirement for staff and agents to actually do so. We suggest that an equivalent to 2.3 is included here. |
| 3.9(b) | Relevant staff and agents should be “adequately” informed of current promotions and representations about credit products. |
| 4.2(b) | “[A] credit agreement where the consequences of missing a repayment or defaulting are high for the borrower... ” |
| 4.5 | “...the inquiries listed at 4.1 a-e above...” |
| 5.2(c) | Replace “electricity” with either “power” or “electricity and gas” to encompass other power sources. |
| 5.16(d) | Customer due-diligence for the purposes of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 should be referred to in section 2 as it is an obligation that applies before the agreement, not an obligation connected to the lender’s inquiries into and assessment of substantial hardship. |
| 7.23(c) | Delete “all online and print material are” and replace with “all relevant promotional material is” to encompass, for example, SMS messages and billboards. |
| Statement of lender responsibility, page 26 | An extra space is required between “hardship” and “(see s 9C(4)(a) of the Act). |

| Reference | Drafting comments |
|---------------------------|--|
| 9.2b | Reference to “[l]f relevant” is superfluous because the introduction to the whole list already says “where relevant”. |
| Second example on page 44 | The critical point is that the cost of the premium may be disproportionate to the amount and term of the loan. The example needs to refer to the cost of the premium (as paragraph 9.5 in fact does). |
| 9.8b | It is not clear what the words “or an insurance policy is the only one that effectively relates to the credit agreement” add. It seems unlikely that a consumer credit contract will be sufficiently unique that it would need unique credit-related insurance, but if it did then the insurance would be from a particular insurer or insurer anyway. Suggest the words be deleted. |
| 9.9 | There is a mistake in this paragraph. The paragraph applies to all relevant insurance contracts, but then excludes relevant insurance contracts that are arranged by the borrower and not the lender. However the relevant insurance contracts covered by responsible lending must be arranged by the lender (section 9B), so the exclusion is effectively meaningless. |
| 9.10b | It is not clear whether the reference to the amount of interest payable means an annual rate or a dollar amount. Presumably it should be both. |
| 9.12 | Cross reference should be to paragraph 9.10. |
| 10.3(c) | The introductory sentence before paras i and ii should use the same words as in the same place in para 10.7 (i.e. “Lenders should apply the following:”) |
| 10.7 | Third line, should refer to costs <i>and losses</i> incurred |
| Section 11 | Principle – the cross reference under the initial Principle should be to section 9C(2)(a)(iii) |
| Footnote 19 | Reference should be to section 9F(1)(b)(iv) etc . |
| Commentary on page 65 | Reference should be to section 9C(3)(d). |

Attachment C: Suggested re-drafting of Section 4

Guidance

Inquiries

- 4.1 A lender must make the reasonable inquiries required to be satisfied that it is likely that the credit provided under the agreement will meet the borrower's requirements and objectives.
- 4.2 A lender will need to make a judgement, based on the matters set out at 4.4 and 4.5, as to the number and kind of inquiries they should make; and the extent and kind of information they should seek, for any given transaction in order to comply with this lender responsibility. Whatever judgement the lender makes, the lender must be able to demonstrate that it has complied with this lender responsibility and that the number and extent of inquiries was reasonable and provided a sufficient basis for the lender to assess whether it is likely that the credit agreement would meet the borrower's requirements and objectives.
- 4.3 The reasonable inquiries about the borrower's requirements and objectives could include inquiries about~~In assessing whether it is likely that the credit provided under the agreement will meet the borrower's requirements and objectives, a lender should inquire into and have regard to the following matters, where relevant:~~
- a. the amount of credit sought or the maximum amount of credit sought by the borrower (such as the credit limit for a credit card):
 - b. the purpose for which the credit is sought:
 - c. whether the credit is required on a one-off basis for a specific need at that time, or over a longer timeframe for expenditure on an ongoing basis:
 - d. the timeframe for which the credit is sought (i.e. the term of agreement that the borrower is seeking if any particular term is sought):
 - e. whether the borrower seeks particular product features or flexibility, the relative importance of different features to the borrower, and whether the borrower is prepared to accept any additional costs or risks associated with these features:
 - f. whether the borrower requires any additional expenses, such as premiums for insurance related to the credit or payment for extended warranties or repayment waivers, to be included in the amount financed, and whether the borrower is aware of the additional costs of these expenses being financed.
- 4.4 ~~Whether the lender should make all of the above inquiries and the extent of the information they should seek under this lender responsibility may differ depending on a number of factors. A greater number of inquiries should be made and more extensive information should be sought for:~~

- 4.4.1 a complex or uncommon credit product, such as a buy-back transaction or reverse equity mortgage:
 - 4.4.2 a credit agreement where the consequences of missing a repayment or defaulting are high, such as potential loss of an asset, or where default interest plus default fees are high relative to the amount of the loan or the credit limit:
 - 4.4.3 a credit agreement where the loan amount is large relative to the borrower's ability to repay:
 - 4.4.4 a borrower with characteristics that may make them vulnerable, such as a borrower for whom English is a second language or who appears to lack basic knowledge about financial matters.
- 4.5 The number of inquiries a lender should make may be fewer and the amount of information sought may be less for:
- 270.1 a credit agreement where the loan amount is small relative to the borrower's ability to repay; a simple credit agreement that is widely understood, such as a credit card or overdraft;
 - 270.2 an existing customer of the lender who has previously had the same or a similar credit agreement product provided by that lender before, without encountering any problems or repayment difficulties;
 - 270.3 an experienced user of credit.
- ~~4.4. The lender can make a judgment as to the number and extent of inquiries that should be made for any given transaction based on the matters set out at 4.2 and 4.3. However, the lender should be able to demonstrate that the number and extent of inquiries was reasonable and provided a sufficient basis for the lender to assess whether it is likely that the credit agreement would meet the borrower's requirements and objectives.~~