COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

Exposure draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020

Submitted to

Ministry of Business, Innovation and Employment
Competition and Consumer Policy team

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Commerce Commission submission on exposure draft regulations to the Credit Contracts and Consumer Finance Amendment Regulations 2020

Introduction

1. Thank you for the opportunity to provide comment on the regulations to the Credit Contracts and Consumer Finance Act contained in section 69 of the Credit Contracts Legislation Amendment Act (the **section 69 Regulations**), the proposed draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020 (the **Draft Regulations**) and the draft Credit Contracts Legislation Amendment Act Commencement Order we received in January 2020 (the **Draft Commencement Order**).

2. Our objectives in making these submissions are:

   2.1 to assist the development of Regulations that are clear for industry and enforceable by the Commission; and

   2.2 assist MBIE in ensuring that the Regulations reflect policy.

3. In our view Regulations relating to the Lender Responsibility Principles should:

   3.1 describe the minimum inquiries and levels of verification lenders should make; and/or

   3.2 set a bright line determining when a credit agreement will be unsuitable or unaffordable.

4. We consider that there are some gaps in the Draft Regulations that may create uncertainty or enforcement difficulties. There are also some technical amendments that we suggest should be made to the section 69 Regulations, Draft Regulations and Draft Commencement Order.

5. In relation to affordability and suitability inquiries, we do not expect that it will be possible to list all the types of inquiries that a lender should make in in a particular case and we expect that the extent and type of inquiry will depend to some extent on the borrower's circumstances and the type of credit product involved. There are inquiries that are clearly relevant for some products. We do not consider, however, that the nature of the inquiries should depend on the lender.

6. We recognise that it will not be necessary to address all areas of compliance in regulations. Further guidance about compliance with the Lender Responsibility Principles (**LRPs**) can be provided in the Responsible Lending Code, or in guidance produced by the Commission. Of course, the nature of the guidance will have some consequences for its enforceability.

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Requirements and objectives

Inquiries

7. There are inquiries in addition to those set out at clause 4AA that, we suggest, should be made by all lenders offering particular types of credit products. In our view these inquiries are critical in assessing, for these types of products, whether they are likely to meet the borrowers requirements and objectives. For example:

    7.1 Where the agreement is a credit sale, the lender should in our view consider:

        7.1.1 the term of the credit relative to the likely useful life of the asset;

        7.1.2 when the borrower requires possession of the goods the subject of the credit sale.

    7.2 Where the agreement is a reverse mortgage, the value of the property subject to the reverse mortgage and the loan to value ratio will be important in ascertaining whether the loan is suitable. Whether the borrower wants to retain some equity in the property at the conclusion of the contract will be relevant to questions of suitability.

    7.3 If the borrower is seeking to switch or refinance existing credit products, any cost associated with breaking the original agreement and any saving made by refinancing will be relevant to an assessment about whether the product meets the borrower's requirements or objectives.

8. If those inquiries are not incorporated in the Regulations we suggest that the existing inquiries are drafted in a way that is non-exclusive so that they may be required in appropriate cases; for example by making clear that while lenders **must** make certain inquiries, they may need to make other inquiries to comply with the LRPs.

9. There are also situations where it may be useful to set a presumption of unsuitability under regulation under 138(abd)(iv). For example, where a borrower is not obtaining the benefit of the loan agreement (obtaining credit to allow a friend or relative to purchase a car) the credit arrangement could be presumed to be unsuitable unless the lender can prove otherwise.

10. The National Credit Protection Regulations 2010 and provisions in the National Consumer Credit Protection Act 2009 in Australia deem certain credit agreements to be unsuitable in prescribed circumstances (for example in relation to reverse mortgages or where the borrower can only comply with their obligations by selling

their principal place of residence).[1] We suggest that it would be useful to consider whether similar bright line rules would be useful here.

Draw down facilities

11. We are aware that some credit products allow multiple advances to be made over a long period of time without the need to enter into another contract (a **draw down facility**). The Draft Regulations do not specifically address what information lenders should obtain in relation to these products and at what time.

12. A creditor may be satisfied about the affordability and suitability of the entire line of credit when the facility is granted but if the consumer draws down the loan progressively over a period of time, the regulations do not require the lender to check the affordability or suitability of the facility at the time of each later advance, even if the borrower's circumstances have changed.

13. We suggest that creditors should be required to reassess whether a revolving credit contract meets the borrowers' requirements and objectives if a change in those requirements and objectives is reasonably foreseeable.

Repayment waivers/extended warranties

14. We support the inclusion of clause 4AB of the Draft Regulations relating to inquiries for credit related insurance. We suggest that 4AB(2)(a)(ii) is expanded to ensure that the lender obtains information about the types of benefits that the borrower requires as well as ensuring that they would be eligible to claim. We have found cases where borrowers purchase credit related insurance with limited benefits or wide exclusions that significantly affect the value of the product. While we would expect lenders to take steps to ensure that borrowers were aware of the benefits payable under the contract and exclusions under s9C(5)(b), we suggest that these types of inquiries are relevant to the suitability of the product as well.

15. It may be useful to provide greater specificity in clause 4AA(2) of the Draft Regulations. The additional costs of the waiver in some cases can include broker fees which are passed on to the borrower. As currently drafted 4AA(2) is not clear about whether the "additional costs" are limited to the upfront cost of the waiver or insurance or whether they include associated fees paid to third parties in relation to the products.

Affordability

16. In this section we set out some issues we have identified with Draft Regulations 4AC to 4AH.

Timeframe for estimating income and expenses

[1] See section 118 National Consumer Credit Protection Act 2009 and regulation 28LC National Consumer Credit Protection Regulations 2010.

17. We are concerned that the requirement that lenders estimate the borrower's likely income and relevant expenses over a "reasonably foreseeable period" as described in 4AE(a) is not sufficiently clear. We suggest that lenders should be required to estimate the borrower's income over the term of the loan, taking into account any reasonably foreseeable changes.

18. A reasonably foreseeable period of time is, in our view, not a sufficiently precise timeframe. For a borrower entering into a home loan at 45 over a 30 year term, it is arguable that 25 years is not a "reasonably foreseeable time period". However, the borrower's retirement during the term of the loan is clearly a possibility and may well affect the borrower's income.

Post-contract expenses

19. We do not consider that the Draft Regulations clearly deal with post-contract expenses and we suggest that they are amended to explicitly refer to such expenses. In our view lenders should take into account expenses that will occur over the term of the loan (including reasonably foreseeable changes to outgoings) and expenses that accrue during the term of the loan but which are charged after the contract concludes. If a lender does not take into account the relevant proportion of those expenses it is possible that the borrower will not be able to pay them, potentially putting them into substantial hardship. So, for example, failing to allow for rates on a property over the term of a loan may mean that the borrower cannot pay the rates bill when it arises after the contract has concluded. If the borrower's relevant expenses (including post-loan expenses) can be accurately estimated it may not be necessary for a lender to allow for a "reasonable surplus".

20. While the discussion paper says that clause 4AG is designed to formulate an initial estimate of post-contract expenses, it is not clear that it does that. Clause 4AG refers to "likely relevant expenses" but is silent about over what time they should be estimated. The obligation (at clause 4AE) is to estimate the borrowers likely expenses over a "reasonably foreseeable time period". It is not clear that this includes a "post-contract" period. Nor does the definition of "relevant expenses" necessarily suggest that the lender should take into account post-contract expenses.

Discretionary expenses

21. We agree that it is important for lenders to identify any regular or frequently recurring discretionary expenses (as set out in the definition of "relevant expenses" at clause 4AD at (c)). It may be appropriate to provide some flexibility that would allow lenders to discuss with borrowers whether they had an ability to reduce their discretionary expenses so as to be able to make payments on the loan without substantial hardship.[2] This may assist borrowers to obtain access to credit. If such flexibility is provided in the Regulations we suggest:

[2] As discussed in *Australian Securities and Investments Commission* v *Westpac Banking Corporation* (Liability Trial) [2019] FCA.

21.1 That lenders are required to have reasonable grounds to believe that the borrower is able to reduce the discretionary expenses in question;

21.2 That lenders are required to keep records of what reduction needs to be made and that documents the borrower is willing to make the reduction in order to obtain the loan.[3]

Verification

22. The requirement to obtain 90 days' worth of bank statements may be an appropriate minimum standard for information and verification but may reduce access to credit for some borrowers. We are aware of situations where a borrower will not have 90 days' worth of bank statements (such as where they have recently moved to New Zealand) and, in these situations it would appear that the Regulations intend that the lender cannot responsibly lend. This may affect borrowers' access to credit – at least for a period of time. It is not clear whether the regulations are intended to have this effect or whether the requirement to obtain bank statements is simply intended to be a suitable method of verification. If the latter there are of, course, other ways of identifying income and expenses other than bank statements and we would suggest that consideration is given to allowing other methods of verification (such as payslips, invoices, WINZ statements, contracts, accounts or correspondence).

23. Clause 4AG does not provide any clarity about how recent the 90 days' worth of bank statements should be. The statements are to verify "current relevant expenses" but the lack of specificity may create uncertainty. We suggest that if a requirement to obtain bank statements is retained that they are required to cover the immediately preceeding period of 90 days.

24. The Regulation that requires lenders to obtain credit card statements may be unnecessarily limited. Regulation 4A(b) requires that lenders obtain credit card statements "into which the borrower's income is transferred". In our view the regulations should require credit card statements where the borrower uses a credit card to pay relevant expenses, whether or not the borrower's income is transferred to the account.

Potential gaps

25. We have identified a number of areas where the Draft Regulations lack specificity in a way that may create enforcement or compliance issues. We acknowledge that further guidance could be provided in the Code or by the Commission to fill these gaps and that regulation is not necessarily required. However we note:

25.1 Apart from the requirement to obtain bank statements, the Draft Regulations contain no further information about the extent to which lenders should verify information provided to them by borrowers. As discussed at paragraph 22 above some expenses will not necessarily be recorded on 90 days' of bank

[3] This will likely be relevant to an assessment of whether the agreement meets the borrowers requirements and objectives.

statements (for example school fees paid at the beginning of the year, or rates that are paid yearly). In our view these expenses could reasonably be verified by the lender.

25.2 The Draft Regulations do not provide sufficient detail about the steps that high-cost lenders should take to meet the requirements of section 45F(2)(b) and 45G(2)(b). We suggest that, together with an assessment of any bank statements, high-cost lenders should be required to ask borrowers about whether they have had any other high-cost loans, if so who with, and when. If the borrower indicates they have previously had a high cost loan, the lender should seek details of that loan and verify whether it has an unpaid balance.

25.3 The inquiries about income and expenses do not necessarily address issues relating to credit products such as reverse mortgages where there are not necessarily "payments" under the agreement that need to be assessed against income. In our view relevant questions include:

25.3.1 An estimate of the length of time the borrower wants access to equity;

25.3.2 Whether the borrower wants to retain equity in the property after the loan is paid off.

Issues with RL compliance (other than high-cost lenders)

26. In our view irresponsible lending can occur across the industry and in relation to credit products. We do not consider it can be assumed that any class of lender is compliant or that there are no issues for a particular type of credit contract.

27. You have asked submitters to describe issues seen with affordability assessments outside high-cost consumer credit contracts. We set out some issues we are aware of below. This commentary is based on our responsible lending investigations and recent conversations we have had with banks. In providing this information we note that we have not formed a view as to whether or not any particular practice breaches the LRPs.

27.1 Some lenders do not make inquiries in order to identify the individual income or expenses of the borrower in circumstances where the borrower declares a joint income and/or joint expenses but the other person is not party to the loan agreement. In October 2019 the Commission warned We Care Finance Limited for failing to make reasonable inquiries so as to be satisfied that the borrowers could make payments on the loan without suffering substantial hardship. The Commission considered that the lender had erred in taking into account the borrower's partners income and expenses when he was not party to the loan contract.

27.2 We have investigated lenders who have failed to take into account key categories of expenses. In 2018 the Commission warned Rapid Loans Limited for responsible lending failures including for failing to obtain information

about a borrower's living expenses in circumstances where the borrower ultimately suffered hardship.

27.3 We are aware that some lenders do not use detailed expense breakdowns from borrowers, using instead benchmarks or broad income/expense ratios to assess affordability.

27.4 Where lenders obtain information from borrowers about expenses, many do not seek any verification even where they hold information about the borrower's actual expenses through account records.

27.5 We also understand that many lenders do not take into account foreseeable changes to income or expenses during the loan term when making affordability assessments, including for home loans.

27.6 There is also a lack of consistency between lenders in what "test" interest rates are used to assess affordability for loans where the interest rate is likely to change during the term of the loan. We are aware of one lender that used a test rate lower than the actual interest rate offered to the borrower.

27.7 We are aware that some lenders use outdated benchmarks to assess or compare borrowers' living expenses. Some use "internal benchmarks" and it is not clear how those benchmarks have been created or whether they form a reasonable basis for benchmarking a borrower's expenses. None of the benchmarks we are aware of vary expenses based on the borrower's geographic location within New Zealand (i.e. they are all on a National basis).

27.8 We understand that some lenders simply use account conduct history as a basis for satisfying themselves about affordability, particularly when granting overdrafts.

Guarantors

28. Guarantors guarantee performance of the borrower's obligations under the Act and, generally speaking, the lender retains some discretion about exactly what the guarantor is required to do. For example, a lender may call up the debt and require the guarantor to repay the entire amount owing under the contract, or alternatively the lender may require the guarantor to make regular payments due under the loan agreement. In some cases, a guarantee may involve a guarantor giving security over an asset in order to guarantee the loan.

29. We suggest that a lender would need to make (at least) the same inquiries of a guarantor about affordability as it does a borrower and should also make sufficient inquiries to ensure that the guarantor could pay out the credit contract without substantial hardship if required to by the lender. This could involve inquiries into whether the guarantor has sufficient non-essential assets to meet the obligation and whether they are prepared to sell assets to meet the borrowers' obligations. Where a guarantee involves the lender taking a security over an asset we suggest that the

lender should make inquiries about whether the sale of the asset would cause substantial hardship to the guarantor.

Advertising

30. We suggest that regulation 4AJ of the section 69 Regulations incorporates regulation 4AAA and 4AAB (contained in the Amendment Act) in order for a penalty or remedy to attach.

Disclosure of agreed changes

31. Clause 4F(1) should apply for the purposes of 22(1)(b) not 22(1) as currently drafted. We understand that these regulations are to prescribe the information that a lender must provide to borrowers in addition to the "full particulars of the change" set out at 22(1)(a).

32. We also suggest adding a rider to 4F(2) that clarifies the distinction between 22(1)(a) and (b): for example adding a statement "*to the extent that it has changed as a result of the variation and is not required to be disclosed under s 22(1)(a)*".

33. We suggest 4F(h)(iv) should read "when the first **or next** payment is due" as a variation occurring during the life of a contract will usually not be the first payment.

34. Clause 4F uses the word "variation". We note that the section otherwise uses the word "change". We suggest that there is benefit in using language that is consistent with the section.

Disclosure at commencement of debt collection

35. In our view, disclosure off "ongoing … default fees … that will continue to be charged under the contract" at Draft Regulation 24(c) is insufficiently precise. The drafting (and specifically the word "continue") suggests that the Draft Regulation only requires disclosure of the type of default fees that have already been charged. It may be that other types of default fees can be charged under the contract. In our view these should be disclosed as well.

36. We also consider that borrowers should be told the date that default fees will be debited or the circumstances that will give rise to a default fee.

37. The discussion paper asks whether all disclosure requirements are appropriate for credit contracts that are not also consumer credit contracts in that they do not charge interest or fees. We understand that the new provisions may catch some buy-now-pay-later schemes. We have little information on how those schemes enforce contracts but note that in ASIC's 2018 *Review of buy now pay later arrangements*[4] it found that in Australia some schemes obtain 25% of revenue in missed payment fees. It also noted the potential risks to consumers of financial overcommitment posed by those schemes.

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[4] Report 600 November 2018: https://download.asic.gov.au/media/4957540/rep600-published-07-dec-2018.pdf

Annual return

38. Information provided from lenders in the annual return will assist the Commission in its monitoring and enforcement function. The information will help us to identify where potential harm to borrowers is occurring and to prioritise our work, including developing appropriate and targeted guidance to lenders and borrowers. As we accumulate this information over a number of years it may provide some insight into the impact of our work. For these purposes it is important to obtain:

    38.1 Information about the number of loans a lender has entered into over the period and the average term of loans and information about interest rates. This will help us to understand who is operating in the industry what sort of loans they are providing.

    38.2 Information about the number of defaults, repeat borrowing and rollovers and refinancing will assist us in identifying potential Responsible Lending issues;

    38.3 Information about the number of insurance and repayment waivers sold and the number of claims will provide us with information about the size of that industry and will provide some information about the value of those products;

    38.4 Information about high cost lending will provide us with information about how many lenders are lending at or under the cap, which will assist us to understand how the rate of charge cap and the total cost cap is working.

39. The information listed at paragraph 140-144 of the discussion paper relates to "car finance". However, we would find information about credit related insurance and repayment waivers sold throughout the industry useful.

Commencement order

40. We have identified some technical issues with the draft Commencement Order (January 2020).

    40.1 From 1 June 2020, mobile trader contracts that are credit sales (and do not charge credit fees or interest) will be treated as consumer credit contracts under the CCCFA.[5] However, the draft Commencement Order proposes that the amendments to the Fair Trading Act 1986 (**FTA**)[6] which clarify cancellation disclosure obligations, where a sale is both a consumer credit contract and a layby sale, commence on 1 April 2021. We recommend commencement dates for these provisions are aligned (to 1 June 2020). Otherwise, mobile trader contracts (and other consumer credit contracts that are also layby sales) will still need to disclose CCCFA cancellation rights (as well as layby cancellation rights under the FTA) until 1 April 2021.

5 CCLAA, s 2

6 CCLAA, subpart 1 of Part 2.

40.2 The amendments to the Financial Service Providers (Registration) Regulations 2010[7] (which prescribe the contents a creditor's registration of the FSP Register) are proposed to come into force on 1 June 2020, before the certification regime, under new Part 5A, comes into force on 1 September 2020.[8] This would require information about certification to be provided on the register before certification is available.

40.3 We recommend that new clause 4A(a) of Schedule 2 under the FSP regulations (information about consumer credit contracts) comes into force on 1 June 2020 but clause 4A(b) and 4A(c) (information about certification) come into force on 1 April 2021. This is the Commission's preference because it would be beneficial to have information about the number of consumer creditors as soon as possible. However, we think that certification details should not be displayed until the first day on which any lender or mobile trader is required to be certified. We see no benefit in certification information being displayed before this date but there is a risk that creditors or mobile traders may misrepresent the effect of their certification to consumers. While this is the Commission's preference, this may require amendments to the CCCF regulations made under s 68 of the CCLAA.

40.4 If this is not possible, we recommend that section 68 of the CCLAA comes into force on 1 April 2021, which is the first date that any consumer creditor or mobile trader will be required to be certified by.

40.5 We draw your attention to ss 10(5A) and s52 of the CCLAA which are not specified in a subsection under clause 2 of the draft commencement order. While clause 2(4) provides a backstop of 1 April 2021, we understand that it is MBIE's intention that all amending sections of the CCLAA are specified under the relevant subsection in the draft Commencement Order.

7 CCLA, s 68.
8 CCLA, s 50.