

16 September 2020

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

Commerce Commission Submission on Affordability and Suitability Exposure Draft Regulations #3

Introduction

1. Thank you for the opportunity to provide further comment on the third version of the draft of affordability and suitability regulations (the **Third Revised Draft Regulations**).
2. This letter should be read in conjunction with staff submissions on the previous draft regulations, dated 7 February 2020 and 6 July 2020, respectively.

General Feedback

3. We welcome the “minimum requirements” approach that has been adopted regarding both the suitability and affordability assessments.
4. We also welcome the change to stating prescribed inquiries as inclusive, rather than exclusive, to ensure appropriate inquiries are made in addition to those that are prescribed, depending on the particular circumstances.
5. In our July submissions, we stated that as a regulator, it was important to ensure that regulations are not unduly complex to assist with enforcement. In our view the Third Revised Draft Regulations is simpler than the previous version, and that the wording aligns more closely with the wording in the Credit Contracts and Consumer Finance Act 2003 (the **CCCFA**).

Specific Feedback

Suitability Assessment

6. We support the “minimum requirement” approach that is proposed under the Third Revised Draft Regulations in assessing suitability. However, there are a number of specific issues that we have identified with the current drafting. We have noted these below:

- a. Regulations 4AA(2) and 4AA(3) require that a lender must “determine” and make a “determination”, respectively. We note that the policy commentary provided in support of the Third Revised Draft Regulations explains that this language is intended to make it clear that a lender needs to make inquiries in order to come to a view about aspects of the borrower’s requirements and objectives. We understand this rationale, however we suggest that using the same word (or root word) when referencing two different actions could give rise to confusion. It may be preferable to change r4AA(3) to require that the lender “make the assessment” required by 9C(3)(a)(i). This would be consistent with the wording of the CCCFA as well as the wording in the heading for r4AA.
- b. It is not clear to us whether r4AA(2)(h) is intended to apply where a borrower is seeking to refinance a loan with the same lender, another lender, or in both scenarios. We also think it is relevant to explain to the borrower the overall cost impact of making the change – will not always be limited to additional fees charged as a result of refinancing (for example, if a longer term loan will mean more interest paid over the life of the loan), and as such we recommend the requirement be expanded to impose an obligation to disclose this to the borrower where possible.
- c. Although we recognise the intent behind r4AA(2)(i)(i) (which relates to inquiries regarding to reverse mortgage applications), we are concerned that the nature of these inquiries are not as amenable to prescription as other proposed suitability inquiry requirements. Our concern lies with the fact that even if a prospective borrower were able to indicate when they expected to enter aged care, the amount of equity that they wished to retain in their property will depend heavily on assumptions made by the lender about future interest rates and house price growth. It might be appropriate to caveat the content by stating that any assessment may be “based on reasonable assumptions”, however we remain concerned about lenders’ ability to comply with this requirement generally based on the many contingent factors.
- d. We suggest that more thought is required in relation to the application of r4AB:
 - i. Regulation 4AB appears to apply more narrowly than the Lender Responsibility Principles (LRPs). A narrower application will leave open questions of how lenders will comply with suitability requirements in respect of other products to which the LRPs apply but which are not covered by the regulations. The effect of the definition of repayment waivers and extended warranties in section 5 in combination with section 9B(4) of the CCCFA is that the LRPs apply to extended warranties and repayment waivers “between a creditor or lessor and a debtor or lessee” and that are “involved” with the credit

agreement. However, the specific requirements for suitability inquiries under r4AB(1) only apply where an extended warranty or repayment waiver is “financed under an agreement” and in respect of extended warranties purchased after the agreement is entered into “with the knowledge of the creditor”. Our view is that the scope of regulations should align with the scope of the LRPs – to provide otherwise is to introduce complexity and ambiguity.

- ii. Regulation 4AB(2) introduces ambiguity about what it means to finance something “under an agreement”. In our view something that is purchased after the agreement with money obtained under the agreement is not “financed under the agreement” unless it is contemplated by the agreement itself. An alternative reading is likely to significantly expand the scope of other provisions of the CCCFA, such as the credit fee provisions which apply to fees or charges payable “under an agreement”.
 - iii. The requirement that the lender “knows” that the borrower has purchased credit related insurance with money obtained under the agreement adds further complexity and ambiguity to the application of the regulations. The LRPs apply to credit related insurance that is “arranged” by the lender, whether or not it is purchased at the same time as the agreement is entered into. There is no requirement that the lender “knows that the borrower is using money obtained on finance to pay for the insurance”. The misalignment in application between the principles and the regulations means that lenders still have obligations in “relevant insurance contracts” where it cannot be shown they “knew” credit was to be used to pay for the insurance but they will not have to comply with the regulations.
- e. We query whether the appropriate test has been applied in relation to the inquiries required at r4AB(3)(a). As currently drafted, the lender should make inquiries to assess whether “the borrower **requires** the waiver, warranty, or insurance” (emphasis added). We assume that the word “require” has been used to reflect the obligation under s9C(5)(a)(i) to ensure that the insurance product will meet the borrower’s “requirements”, however we suggest that an assessment as to whether a product is “required” as opposed to will meet “requirements” are quite different. A borrower may seek certain benefits provided under an insurance product, but it does not necessarily follow that they “require” the product. We suggest that the wording therefore be changed to “whether the waiver, warranty, or insurance will meet the borrower’s requirements and objectives, which”.
- f. We also recommend that you consider whether it is appropriate that r4AB(3)(a) be changed to require that the creditor “must” make the listed inquiries, rather than “may” – further inquiries may be appropriate in certain

situations, but in our view the list of inquiries in the regulations should provide the minimum requirements.

- g. Lenders may be concerned that the breadth of r 4AB(3)(a)(ii) could imply an obligation to complete a full assessment before an application is made to determine if the borrower will not be ineligible to claim under the policy. We support retaining a requirement to include inquiries as to eligibility, but it may be appropriate to consider the extent to which the scope of these inquiries could be limited to “entry level” criteria (rather than, for example, inquiries into any pre-existing conditions).

Affordability Assessment

7. We support the simpler approach that has been adopted in the latest draft regulations, however we list our specific feedback on certain elements below:
 - a. We note that the definition of “income” at r4AE references “other similar deductions”. We take it from this that “similar deductions” would be restricted to those deductions that are akin to KiwiSaver, and tax, and thus may exclude other deductions such as student loan payments. We query whether the word “similar” is needed in this context, as the key consideration should be what the net income that is actually received to the borrower’s bank account, regardless of what deductions are made prior.
 - b. We note that the definition of “listed outgoings” at r4AE includes categories of outgoing types. The fourth category – any regular or frequently recurring outgoings – specifically provides that a borrower can indicate whether or not they intend to continue to incur those expenses after taking out the loan. We would like to understand whether it is intended that borrowers be able to indicate an intention to discontinue outgoings that fit into other categories, on the basis that expenses are assessed on a forward-looking basis. For example, a borrower may indicate that they will no longer be liable for school fees (or not at the level indicated based on current levels) due to their child changing from a private school to a public school after taking out the loan.
 - c. We are not clear why there is a distinction between “relevant expenses” for an agreement that is a high-cost consumer credit contract and an agreement that is a consumer credit contract, but not a high-cost consumer credit contract. The definition of “relevant expenses” at r4AE indicates that in the case of a credit contract that is not a high-cost consumer credit contract, consideration must be given to the extent to which the borrower “will rely on income to meet [the listed outgoings] directly **or indirectly**”. We would like to understand better:
 - i. Why a different assessment is necessary? And
 - ii. How listed outgoings might be met “indirectly” from income?

- d. We would like to better understand how the full income and expense assessment is intended to work where the borrower will only be relying in part on their income. Regulation 4AF(1)(b) is clear that a full assessment is required in such circumstances, but if income is only to be relied on in part we have concerns over the extent to which a lender can be satisfied that the borrower is likely to be able to meet their obligations without suffering substantial hardship. If a borrower will be relying on some means other than just their income it seems unlikely that their income will exceed their expenses, as required by the full income and expense assessment.
- e. We note that the regulations do not provide for any particular treatment when considering floating interest rates. We suggest that consideration be given to providing guidance on how to take this into account in the Responsible Lending Code.
- f. We remain of the view that the exemption provided for by r4AG is not required, and that some level of inquiry into income and expenses will always be necessary. We are also concerned with the use of the imprecise and undefined measures including “obvious” and “disproportionate”. However, we note the Policy Commentary provided in support of the Third Revised Draft Regulations is clear is that r4AG is intended to apply in limited circumstances. We suggest that there be content in the Responsible Lending Code dedicated to providing guidance on how this exemption is intended to apply.
- g. We suggest that the wording of r4AH(1)(a) be reviewed as we are not clear that the reference to the “same lender” is clear that this relates to the lender under the existing consumer credit contract.
- h. We suggest that r4AI is amended to make it clear when it is intended to apply (for example, is it intended to apply where r4AF does not apply and nor do either exception provided for in r4AG and 4AH).
- i. We would like to understand how lenders are expected to respond to the outcome from the inquiries prescribed by r4AJ(2)(b) in conducting their assessment, particularly in cases where the borrower expects their income to change over the course of the relevant period (indicating their ability to meet the payments under the agreement will fluctuate during the period).
- j. We note that r4AK provides a basis for lenders to estimate borrower’s likely expenses based on data it holds, which would include transactional data. It is our preference that lenders be expressly obliged to consider and assess any held information when conducting an affordability assessment. This information is likely to give a more complete picture about income and outgoings than the other means provided for under the regulations.

- k. We note that r4AK provides for different requirements where an agreement is a high-cost consumer credit contract. It is likely that these inquiries could result in the lender being put on notice that the borrower has had prior high-cost consumer credit contracts, which could help ensure compliance with the restrictions on lending to repeat borrowers. We suggest that to expand on this the regulations provide that lenders of high-cost consumer credit contracts are required to ask borrowers:
 - i. whether the borrower has or recently had other loans;
 - ii. what the interest rates are or were on those other loans
 - iii. when they entered into those loans; and
 - iv. whether the loans have been repaid
- l. We are unclear as to how lenders should make the assessment required by r4AM(3), and what a “reasonable minimum cost of living” is to be measured against. Our reading is that it indicates that this assessment should be undertaken in all instances (including when expenses have been verified), not just when expenses are estimated. If this is not what is intended we suggest that you revisit the drafting.

Other Comments

- 8. The Policy Commentary provided in support of the Third Revised Draft Regulations suggests that lenders should ask borrowers to confirm if they expect their expenditure to change after taking out a loan, and that (impliedly) lenders can rely on this feedback in conducting their affordability assessment. While we agree that flexibility is appropriate for certain classes of expenses, we caution against suggesting that this approach should be treated broadly across all expense categories. At the very least we expect the lender to make an assessment as to whether the information provided by the borrower is likely to be reasonable. It may be useful to ensure that the Responsible Lending Code expands on this.
- 9. Please contact me if you would like to discuss anything contained in this letter.

Yours sincerely



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