





Regulatory Impact Statement

Responsible Lending Code

Agency Disclosure Statement

This regulatory impact statement has been prepared by the Ministry of Business, Innovation and Employment (MBIE).

It provides an analysis of options for the Responsible Lending Code required by the Credit Contracts and Consumer Finance Act 2003 (CCCFA). The Responsible Lending Code (the Code) provides guidance on the new lender responsibility principles introduced into the CCCFA by the Credit Contracts and Consumer Finance Amendment Act 2014. These principles will require creditors under consumer credit contracts to be responsible lenders – for example, to be satisfied that borrowers can make repayments without suffering substantial hardship.

The impacts of the Code are limited by the fact that it is non-binding. However, this RIS has been prepared on the basis that the Code is likely to influence lender behaviour.

The options considered in the RIS are also constrained by the primary legislation: the Minister is legally obliged to issue the Code, and the content of the Code must conform to the lender responsibility principles in the amended CCCFA. The Code cannot assert obligations beyond those already covered by the law. And because it is not a “safe harbour” (lenders can be liable for breaching the lender responsibility principles, even if they follow the Code) it also cannot “read down” the lender responsibility principles to an extent that would not be consistent with a court’s interpretation of those principles.

The timeframe over which the Code has needed to be prepared (the Act was passed on 6 June 2014 and comes into force on 6 June 2015) have also constrained the options available. In particular, it is not feasible to develop a Code that gives detailed guidance on compliance for a large number of specific categories of lenders. Instead, the guidance either needs to be relatively general (and therefore applicable to a wide range of lenders) or, where it is more detailed and prescriptive, it can only focus on selective types of lenders and situations.

There are some additional limitations of the analysis undertaken:

- The analysis is based largely on impacts identified in submissions received in response to a July 2014 discussion document on the Code, and a draft of the Code publicly released in November 2014.
- A few submitters provided information about costs associated with complying with aspects of the draft Code, but it is difficult to determine to what extent these costs should be attributed to the Code against the lender responsibility principles that the Code gives guidance on.

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Date

Introduction

- 1 Parliament passed a number of changes to consumer credit laws in 2014. The objective of the amendments is to revise and update the law that governs consumer credit so that creditors lend to consumers and manage consumer credit contracts responsibly. The amendments provide improved protection for vulnerable consumers, including from unscrupulous lenders. They include requiring lenders to comply with lender responsibility principles, reforming laws around repossession, changes to disclosure, and increased penalties for creditors that breach credit laws.
- 2 The main changes are to the Credit Contracts and Consumer Finance Act 2003 (the CCCFA), which is the primary law that regulates the provision of consumer credit and sets out ongoing obligations of those who provide credit.
- 3 The changes are being made through the Credit Contracts and Consumer Finance Amendment Act (Amendment Act), which was passed into law on 6 June 2014. Most of the changes have not yet taken effect, but will do so by 6 June 2015.

Lender responsibility principles

- 4 A key feature of the reforms is the introduction of new lender responsibility principles and lender responsibilities, which will also come into force by 6 June 2015.
- 5 The objective of the responsible lending obligations is to reinforce and set good lending practices in order to protect consumers, and to promote informed choice and effective competition in consumer credit markets. The responsible lending obligations target the practices of unscrupulous lenders, and are aimed at preventing unaffordable or otherwise inappropriate lending, and misconduct by those lenders.
- 6 The lender responsibility principles require lenders to:
 - a. exercise the care, diligence, and skill of a responsible lender when advertising credit, and before and after providing consumer credit
 - b. comply with specific lender responsibilities.
- 7 The specific lender responsibilities may be summarised as follows:
 - a. make reasonable inquiries so as to be satisfied that it is likely that the credit or finance provided under the agreement will meet the borrower's requirements and objectives
 - b. make reasonable inquiries so as to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship
 - c. assist the borrower to reach an informed decision as to whether or not to enter into the agreement and to be reasonably aware of its full implications
 - d. assist the borrower to reach informed decisions in all subsequent dealings in relation to the agreement
 - e. treat the borrower and their property (or property in their possession) reasonably and in an ethical manner
 - f. ensure that agreements are not oppressive, the lender does not exercise a right or power conferred by the agreement in an oppressive manner and the lender does not induce the borrower to enter into the agreement by oppressive means
 - g. meet all the lender's legal obligations to the borrower

- 8 Many of these obligations also apply to lenders' conduct towards guarantors, and towards those taking credit-related insurance.

The Responsible Lending Code

- 9 The amended CCCFA provides for the development of a Responsible Lending Code (Code), which must be issued by Minister of Commerce and Consumer Affairs.
- 10 The purpose of the Responsible Lending Code is to elaborate on the lender responsibility principles (including the more detailed lender responsibilities) and offer guidance on how those principles may be implemented by lenders. The Code may set out processes, practices or procedures that a lender should follow to comply with the lender responsibility principles.
- 11 The Code is not binding: lenders can satisfy the lender responsibility principles in other ways. Nor is it a safe harbour: lenders can be liable for breaching the lender responsibility principles even if they have followed the Code.
- 12 However, the amended CCCFA will provide that evidence of a lender's compliance with the provisions of the Responsible Lending Code is to be treated as evidence of compliance with the lender responsibility principles. This means that the Code may make it easier for lenders to determine what their obligations are and to meet them.
- 13 An earlier analysis of the regulatory impacts of the responsible lender principles and the Code is available in the October 2011 regulatory impact statement, *Responsible lending requirements for consumer credit providers*.¹

Status quo and problem definition

- 14 Currently there is no Code in force.
- 15 The Minister is required by the Amendment Act to issue a Code before the amendments to the CCCFA come into force (by 6 June 2015), and that Code needs to meet the purposes of the Code set out in the Act. These are to:
- a. elaborate on the lender responsibility principles
 - b. offer guidance on how those principles may be implemented by lenders.
- 16 While issuing the Code is mandatory, it is still useful to consider how the lender responsibility principles would operate in the absence of a Code. This assists an understanding of the role of the Code, and the problems it aims to address.
- 17 If a Code were not required, the lender responsibility principles could operate on their own. They are a self-contained and will be enforced directly by the Commerce Commission and through the courts.

¹<http://www.consumeraffairs.govt.nz/pdf-library/CCCFA-RIS-Responsible-Lending-Requirements-for-Consumer-Credit-Providers.pdf>

- 18 However, the 2011 RIS noted that there was uncertainty about how lenders would meet particular responsibilities, such as being satisfied that the credit or finance provided under the agreement will meet the borrower's requirements and objectives. The Code was seen as a way to mitigate costs associated with this uncertainty, and to place clearer expectations on lenders.
- 19 In the consideration of the Credit Contracts and Financial Services Bill, submitters to the select committee were of the view that the responsible lending principles could not sensibly apply ahead of the Code, because the Code would be necessary to interpret the principles. Some industry submitters suggested that in the absence of guidance, diligent lenders would take a necessarily conservative approach to compliance with the responsible lending principles, which would make it more likely that borrowers were excluded from receiving loans.

Objectives

- 20 The Code, similar to other guidance, is intended to provide greater certainty about the lender responsibility principles. As noted above, this can have benefits for lenders who otherwise incur indirect costs in interpreting and applying the legislation themselves.
- 21 On the other hand, guidance may cause lenders to take steps they otherwise wouldn't, which has direct costs associated with it.
- 22 The Code should also support other purposes of the lender responsibility principles, such as promoting good lending practices that protect and inform consumers. Again, this needs to be weighed against the possibility that in following guidance, lenders harm consumers by unnecessarily or excessively restricting access to credit.
- 23 The options will therefore be assessed against the following objectives:
- a. Does this approach to the Code provide greater certainty about the meaning of the lender responsibility principles, and assist lenders to comply with them?
 - b. Does this approach to the Code promote good lending practices that protect and inform consumers?
 - c. Does this approach to the Code minimise direct compliance costs and additional restrictions on access to credit?
- 24 We consider that the options that best meet the objectives are most likely to achieve the updated purposes of the CCCFA, including to protect the interests of consumers and to facilitate the fair, efficient, and transparent credit markets in New Zealand.

Regulatory impact analysis

- 25 We have considered three options for the Code, which range from a 'least detailed' option to a 'most detailed' option:
- Option 1: A 'minimal' Code that simply restates the lender responsibility principles and gives examples of practices that may assist with compliance
 - Option 2: A more substantive Code that provides general guidance about what lenders should do to comply with the lender responsibility principles in different situations, but leaves considerable flexibility and lender judgement in most cases (preferred option)
 - Option 3: A detailed Code that provides minimal general guidance, but sets out optional processes in detail that, if followed, would be likely to constitute compliance

Option 1: A minimal code

- 26 Option 1 is for the Code to simply restate the lender responsibility principles, with some examples of practices that may assist with compliance. This approach is as close to the status quo of 'no code' as possible.
- 27 The Code would state, for example, that (mirroring the Act):
- Lenders must make reasonable inquiries so as to be satisfied that the borrower will make the payments under the agreement without suffering substantial hardship.
- 28 The Code would then give a non-exclusive list of examples of what lenders may consider in meeting this responsibility:
- Lenders may inquire into matters such as:
- the borrower's income
 - the borrower's expenses and other outgoings
 - the borrower's credit history and other aspects of the borrower's likelihood of repayment
- 29 These examples would give a flavour of what the lender responsibility means, but would expressly not require lenders to do anything additional in order to be Code compliant. Lenders would effectively decide for themselves how they would go about complying with the lender responsibility principles (and therefore the Code).

Option 2: A substantive Code (preferred option)

- 30 Option 2 is for the Code to attempt to give a greater level of guidance as to what a lender *should* do to comply with the lender responsibility principles. This guidance would be, in general, based on the policy intention of the lender responsibility principles and the Ministry's interpretation of the lender responsibility principles.
- 31 In the case of the lender responsibility principle, "make reasonable inquiries so as to be satisfied that the borrower will make the payments under the agreement without suffering substantial hardship", the Code could state, for example, that:
- To meet this lender responsibility, a lender should be satisfied that it is likely that the borrower will make the payments under the agreement as well as:
- a. meet necessities (such as accommodation, food, power, telephone, clothing, required medical expenses); and
 - b. the borrower's other financial commitments (such as payments on existing debt)
- without having to realise security or assets that the borrower is does not intend to dispose of.
- 32 The Code would expand further on these matters. For example, it may state that a borrower's inquiries into income should include, to the extent reasonable, the borrower's current income level, the stability of that income, and (if relevant) the borrower's intended impending proceeds of sale of assets.
- 33 Further guidance would be given for particular situations where there was a higher risk of consumer detriment, such as:
- A lender should seek more extensive information in relation to each inquiry, including supporting documentation where appropriate, for:

- a. 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
- b. a credit agreement where the size of the loan is large relative to the borrower's ability to repay
- c. a high-cost credit agreement
- d. a borrower with characteristics that may make them vulnerable.

Option 3: A detailed Code

34 Option 3 is for the Code to give minimal general guidance applicable to all lenders, but to prescribe specific processes that *could* be followed by a lender, or specific types of lenders. The Code would be clear that lenders for whom a section was inapplicable or undesirable are free to adopt their own approach to the lender responsibility principles. The specific processes would be prescribed in much more detail than under Option 2.

35 For example, in the case of the lender responsibility principle, "make reasonable inquiries so as to be satisfied that the borrower will make the payments under the agreement without suffering substantial hardship", the Code would first restate the principle in the Act. It would then set out a particular procedure that lenders could perform (but which was not mandatory). This could be something like, for example:

To meet this lender responsibility, a lender could do the following:

- a. Calculate the borrower's uncommitted monthly income and determine that it exceeds a reasonable threshold (such as \$100 per month). Uncommitted monthly income may be calculated as:

Borrower's monthly income from reliable income sources:

minus living expenses, including accommodation, food, utilities, transport, clothing, medical expenses, etc.;

minus existing fixed financial commitments, including repayments on existing debt;

minus monthly payments on the credit contract offered.

- b. Assess willingness to pay by obtaining the borrower's credit history and verifying that the borrower does not have a significant history of missed payments. Before lending, any adverse credit entries should be tested with the borrower.

36 The Code would need to further define reliable income sources, and exclude or discount other sources of income. For instance, it could apply a series of discount factors (from 0% to 100%) to income from sources such as temporary or casual employment, short-term rentals on holiday homes, etc. It would also likely need to set out methodologies for determining living expenses.

Analysis of options

Key:	
✓✓	Meets the policy objective
✓	Partially meets the policy objective
✗	Does not meet the policy objective

	Does this approach provide certainty about the meaning of the lender responsibility principles, and assist lenders to comply with them?	Does this approach to the Code promote good lending practices that protect and inform consumers?	Does this approach to the Code minimise direct compliance costs and additional restrictions on access to credit?
Option 1: A minimal Code	✗ The guidance would add little to the Act, and could not be usefully relied on by lenders. More diligent or conservative lenders may take a risk averse approach to compliance that leads to unnecessary cost.	✗ The guidance would add little to the Act. There is a risk that lenders apply the lender responsibility principles in an inconsistent manner.	✓✓ Lenders will only take the steps that they consider are required to ensure compliance with the lender responsibility principles, or are in their commercial interest.
Option 2: A more substantive Code (preferred option)	✓ Most lenders would find some additional clarity from the guidance.	✓✓ This approach allows the Code to set out best practice generally and target areas where there is a higher risk of consumer detriment, such as high cost lending.	✓ This approach should largely accord with what diligent lenders would do in the absence of the Code (based on their own legal advice about what is required), but will result in less diligent lenders taking additional steps. However, there is a risk that the Code will take a different interpretation of some provisions from that adopted by even diligent lenders, resulting in extra costs.
Option 3: A detailed Code	✓ Some lenders would be given clear direction. Many lenders would receive little guidance. Without frequent updates, the value of the Code would decline over time as technology and lending practices change.	✓ There would be a more consistent and certain level of consumer protection where lenders chose to follow the Code. However, many lenders – even those engaged in more harmful lending – may decide that the Code suggestions are unsuitable to follow and adopt their own compliance practices.	✓ Many lenders would continue to follow their own compliance approaches, and would therefore not incur additional costs. Other lenders may adopt the detailed practices set out in the Code, which in some cases would be additional and more costly than what they would otherwise have done.

- 37 As indicated by the table, Option 1 would eliminate the risk of extra compliance costs caused *directly* by the Code, but would likely result in continuing uncertainty about what the lender responsibility principles mean in practice. It is therefore likely to have its own, difficult-to-estimate costs – for example, legal advice, unexpected regulatory action, etc.
- 38 There is a risk that lenders would apply the guidance in an inconsistent manner, leading to reduced consumer protection. More conservative or diligent lenders may also take a risk averse approach to compliance that increases costs, whereas less diligent or unscrupulous lenders (who pose greater risks to consumers) may respond to the uncertainty by making few changes to their practices to comply with the lender responsibility principles.

- 39 This option would not go very far towards achieving any of the purposes of the Code. It could also result in the Commerce Commission issuing its own guidance to lenders about how it will enforce the lender responsibilities; that guidance would effectively substitute for the Code and may have impacts similar to the other two options.
- 40 Option 2 is likely to provide the most useful guidance to lenders.
- 41 By making it clear that there are greater obligations on lenders making high cost loans or dealing with vulnerable borrowers, it also makes it more likely that there are improvements to lender behaviour in these areas, in advance of any enforcement through the courts. This implies, however, that those lenders are likely to incur greater costs than they would otherwise.
- 42 More generally, under Option 2 all lenders who make use of the Code will incur costs in assessing whether their current practices are aligned with the Code, in addition to being aligned with their own interpretation of the lender responsibility principles.
- 43 There is also a risk that there will be some areas where the guidance in the Code inadvertently goes beyond what is strictly required by the lender responsibility principles or asserts that a particular practice should be followed where a lower cost alternative would be accepted by a court. This option assumes that efforts are made to minimise these occurrences by a careful process of consultation. However, if they are not minimised the costs from them could be considerable. One bank estimated in their submissions that an over-prescriptive approach would impose additional up-front costs of \$1.1 million, with additional ongoing costs. [
-] Due to the omission of most of these types of inadvertently prescriptive requirements, the actual costs associated with the final Code under Option 2 are expected to be much lower.
- 44 Option 3 would give some lenders much clearer direction. However, a detailed Code cannot hope to cover every type of lender and credit contract. As the Code would need to be clear that its detailed guidance only provides one way to comply with the lender responsibility principles, lenders may choose not to follow it for a number of reasons – for example, because it doesn't cover their product, or doesn't suit their particular organisational structure or business model. A detailed Code is also prone to going out of date.
- 45 The effect of this is that only some lenders would benefit from the Code. Only the borrowers of lenders who make use of the Code would receive the clearer protections of the processes in the Code. It seems likely that many of the least diligent lenders (who currently cause the most harm) would ignore the Code under this option.
- 46 Lenders who adopted the practices suggested under Option 3 would in many cases be adopting practices that were additional to or more costly than the practices they would otherwise have selected, in exchange for the benefit of greater legal certainty.

Consultation

- 47 A discussion document seeking views on the Code was released for public consultation in July 2014, and 62 submissions were received. A draft Code was publicly released on 18 November 2014. Submissions closed on 23 December 2014 and 45 were received. Submissions on both documents have informed the analysis in this paper. The Code has also been developed in consultation with a Code Advisory Group, comprising representatives from lenders, consumer groups, dispute resolution schemes and the Commerce Commission.

- 48 Submissions were highly variable in terms of their views on what the Code should try to achieve and what approach it should take.
- 49 In general (but with some exceptions) lenders supported the Code remaining relatively flexible. Some lenders considered that they were already responsible lenders, and so didn't need any further guidance on the responsible lender principles. These lenders tended to view elaborations on the responsible lender principles as adding cost.
- 50 Other lenders considered that guidance would be helpful, or even necessary, to give effect to the responsible lending principles and to satisfy themselves that they were complying with the principles. Some of those lenders, as well as consumer groups, the Commerce Commission and dispute resolution schemes have tended support a more prescriptive approach, incorporating minimum standards and clear boundaries. Those submitters felt that the Code should aim to provide greater certainty and/or clearer consumer protections.

Conclusions and recommendations

- 51 Based on the analysis above, we recommend that the Code be based on Option 2. We consider this option best balances:
- Providing certainty about the meaning of the lender responsibility principles, and assist lenders to comply with them – by providing substantive guidance about what a lender should do to comply with the lender responsibility principles in different situations.
 - Promoting good lending practices that protect and inform consumers – by encouraging a more consistent understanding of lender obligations across the whole industry, and targeting areas where there is a higher risk of consumer detriment, such as high cost lending.
 - Minimising additional compliance costs – by leaving lenders with significant flexibility in most cases, and minimising requirements where they are not clearly implied by the lender responsibility principles.
- 52 *Recommendation: the Code should provide guidance about what a lender should do to comply with the lender responsibility principles in different situations, but leave considerable flexibility and room for judgement in most cases.*

Implementation

- 53 The Code will be issued by the Minister, likely in March 2015, and notified in the Gazette.
- 54 The Amendment Act, including the responsible lending principles and the Code, will come into force by 6 June 2015.
- 55 The Commerce Commission is responsible for enforcing the CCCFA. The Commission will be educating lenders and consumers about the changes to the CCCFA, including the lender responsibility principles and the Code – before and after the changes come into force. This includes seminars in major centres and issuing of fact sheets.

Monitoring, evaluation and review

- 56 Officials will be monitoring the effectiveness of the credit law reforms, with responsible lending being one of the main focuses of this programme of work.
- 57 Six months after the responsible lending principles and Code are brought into force, the Ministry intends to reconvene the Code Advisory Group to give feedback on impact – both the extent to which it is meeting its objectives, and unintended consequences.
- 58 The Ministry is also establishing a baseline for the purposes of formal evaluation, including a consumer survey and desk-based research on the current state of lending (particularly third-tier lenders, such as those offering pay day loans) and advertising. An evaluation will take place based on follow-up research in 2-3 years.