NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Exposure draft of updated Credit Contracts and Consumer Finance Regulations 2004 and Responsible Lending Code

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank N.A.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment (**MBIE**) on the Exposure Draft of the updated Credit Contracts and Consumer Finance Regulations 2004 and Responsible Lending Code (**Exposure Draft**). NZBA commends the work that has gone into developing the Exposure Draft.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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Summary

We appreciate MBIE's engagement with NZBA and its members on the proposed changes to the CCCFA Regulations and the Responsible Lending Code (**Code**). We support the intention behind the proposed changes, but we emphasise again that they do not go far enough and are unlikely to result in any material changes for consumers when seeking credit.

Without a more fulsome review of the Regulations, including changes to the scope of expenses and the requirements around verification, the Regulations will continue to unduly restrict access to credit.

We understand the Minister for Commerce and Consumer Affairs is still considering whether further changes to the Regulations are needed based on the findings of MBIE's investigation. We strongly support further, urgent regulatory change.

Our feedback in this submission is aimed at ensuring the proposed changes (to the Code in particular) are as impactful as possible, while maintaining consumer protection. We welcome the opportunity to discuss this submission with you.

Amendments to Responsible Lending Code

Initial estimate of expenses

Paragraph 5.4

We understand that MBIE's intention here (paragraph 5.4) is to reflect the pre-1 December 2021 process where lenders used transaction statements to sense check information the borrower provides.

We support this intention. It is helpful that the Code confirms that where a lender asks a borrower about their relevant expenses, and has also obtained bank transaction records for another purpose, the lender may rely on what the borrower has told them to estimate expenses.

However, the statement in paragraph 5.4 that a lender must not 'close their eyes' to information in bank statements, and must 'briefly review' borrowers' transactions, is inconsistent with Cabinet's intention when making this change, which is to clarify that when lenders ask about likely living expenses and these are benchmarked, there is no need to also inquire into current living expenses from recent bank transactions. The addition of these sentences to the Code counters the usefulness of the statement at the start of paragraph 5.4, and would also be very difficult to operationalise.

We recommend that these last two sentences of paragraph 5.4 be amended as follows: 'However, lenders should be aware of the risk that likely relevant material expenses have been missed from the borrower's declarations, or that there are other inconsistencies between transaction records and the borrower's declarations.'

Paragraph 5.5

Regardless of how a lender collects expenses, the lender should focus only on *likely relevant expenses* - those expenses the borrower will have after taking out the loan. While this is briefly discussed at paragraph 5.5, we believe the Code should provide express guidance to stress how lenders should apply Regulation 4AK, 'likely relevant expenses', and 'relevant period'. Please see our proposed alternative paragraph 5.5 in the Appendix.

Discretionary expenses

We suggest removing the commentary about potential issues with using bank statements in paragraph 5.6 of the Code. Our members had different views on the utility of that content. Some raised concerns the content may unintentionally discourage use of statements, rather than stress that lenders should capture *likely* expenses and have the flexibility to choose from a range of appropriate means of doing so, including asking the borrower *or* using statements.

We see the real issue as being the current wide definition of "listed outgoings", which captures discretionary expenses that customers will pare back when necessary, and will often reduce when take out a loan. In the absence of changes to the definition of "listed outgoings" in the regulations, we suggest providing further guidance on paragraphs (c) and (d) of that definition.

The Code should draw a distinction between *basic necessities* and *discretionary spend*. The Code provides an example where food expenses change because a borrower will not be eating out as often. This is helpful, but similar issues can arise with clothing and personal care, and with entertainment costs.

We suggest clarifying the lender need only capture basic essential expenditure and basic quality-of-living costs. The Code should clarify that a lender can adjust expenses they are comfortable go beyond that needed for basic necessities for that expense type, confirming the amount used with the borrower as required.

We also suggest providing further guidance on when an expense should be included under paragraph (d) of the definition of 'listed outgoings'.

In particular, a borrower may not be *willing* to cease an expense before taking out the loan, but *could do so* and *would be willing to do so* if they were having financial difficulties. In that case, the lender should be able to omit the expenses from their affordability assessment.

We have suggested some alternative drafting for paragraph 5.6 in the Appendix.

Adjusting the initial estimate of borrower's likely relevant expenses

We see some issues with paragraph 5.8:

- It seems to diminish the benefits of benchmarking, and may undermine the requirement in Regulation 4AM(2)(b) to apply the higher of the declared or benchmarked expenses. Indeed Regulation 4AM(2)(b) may need amendment to reflect the greater flexibility proposed in 5.8(a).
- We also believe the statement at 5.8(c) may be inappropriate where a lender has collected the initial estimate using Regulation 4AK(2)(a)(ii) or (iii). Where a lender confirms with the borrower any expense to be used, having collected that expense under Regulation 4AK(2)(a)(ii) or (iii) a lender need do nothing further. A lender is

only required to further verify those expenses under Regulation 4AM where the lender has asked the borrower about the expense under Regulation 4AK(2)(a)(i). Otherwise, the process becomes circular, and a lender would be obliged to create unnecessary reasonable cost estimates of expenses they've collected through statements but have adjusted on discussion with the borrower.

We propose alternative drafting in the Appendix. We also consider that changes are likely needed to Regulation 4AM(2)(b) to ensure that paragraph 5.8(a) is workable.

Surpluses, buffers or adjustments

We understand that the intent of new paragraph 5.19 is to provide guidance to ensure lenders do not unnecessarily apply overly conservative buffers or adjustments, or surpluses, or both in their affordability assessments. We support this intention, but are concerned that the current drafting will not achieve the necessary outcomes.

As noted previously, we do not agree with an interpretation that says if you have buffers or adjustments in your process, you can *deduct* those amounts from your reasonable surplus to lower the amount of the surplus required. This implies that buffers and adjustments are not an alternative (in their entirety) to a reasonable surplus, despite the structure in Regulation 4AF which is clear that a lender may apply a reasonable surplus *or* buffers or adjustments. Some lenders may choose to apply both, but Regulation 4AF does not require this.

We propose an alternative to paragraph 5.19 in the Appendix. We also suggest MBIE refer to the requirements provided by the Australian Prudential Regulation Authority, the Reserve Bank of New Zealand and banks' internal credit policies.

Guidance on Regulation 4AG

We note that MBIE has engaged with industry feedback on Regulation 4AG and developed more practical examples for when the obvious affordability exception can be used. We agree and support the removal of the reference to this being a 'high test'.

However, we think these changes would be more useful for lenders and provide greater protection for consumers if the examples were prefaced with a non-exhaustive list of factors which may demonstrate that the test in regulation 4AG has been met.

This non-exhaustive list of factors are ones which are experienced frequently by all lenders and are circumstances whereby the use of 4AG is reasonable given they are unlikely to result in the borrower experiencing substantial hardship. These factors are as follows:

> Whether it is obvious that a borrower will make payments under the agreement without suffering substantial hardship is context specific. In establishing that, the lender may consider the following factors:
>
> 1. The amount of the proposed material change is a small percentage of the total credit limit of the existing contract, and the lender is satisfied the borrower's income is likely to exceed the borrower's expenses.
>
> 2. The amount of the lending or the proposed material change is a small percentage of the available security, and the lender is satisfied the borrower's income is likely to exceed the borrower's expenses.

3. The agreement is intended to be temporary, and will be repaid from a verified bonus, commission, or one-off or permanent increase to income.

4. The lender is satisfied the borrower's income is likely to exceed the borrower's expenses, including the new lending, with a generous surplus.

5. The lender is satisfied the borrower can rely on means other than income to meet repayments (whether they intend to do so at that time), including where the borrower has significant savings, investments, or other assets that could be realised if needed.

6. Refinancing debt whether internally or from other lenders, if the refinance or debt consolidation would be in the customer's best interests and where it can be demonstrated that there is no likely financial hardship or harm.

7. The lender has previously completed a full affordability assessment (e.g., in past 12 months), and the borrower confirms that there have been no adverse changes to their financial position (and if there any adverse changes the lender takes these into account).

8. Permitting temporary excesses on arranged credit facilities in circumstances where data or other factors specific to the client indicate to the lender that this would be unlikely to cause substantial hardship (e.g., available funds in other accounts or funds due shortly).

We urge MBIE to include all the above wording into 5.26. If any of these factors are not included in the Code, the industry will remain unclear in terms of the practical application of 4AG; particularly for those factors that may not have been included. The Code should be clear where the Ministry believe that these circumstances are not ones that should be subject to the 4AG exemption.

The risk with providing only examples is that it creates difficulties for lenders as it raises questions as to what can and can't be deduced from the specific scenario and the parameters of when it is appropriate to apply 4AG.

When prefaced by some criteria, or factors that may be taken into account by the lender, we consider there is greater consumer protection as the policy intent of the regulation is clearer for lenders and can be applied with more consistency and certainty.

We also consider that the guidance on Regulation 4AG would benefit from two additional examples of situations which are common to lenders:

- A refinance situation where refinancing from one lender to another lender is in the best interests of the customer and there is no increase in lending.
- A situation where the lender has previously completed a full affordability assessment and the borrower confirms there have been no adverse changes in their financial position (or else takes into account those changes).

For the refinance situation, we suggest an example along the lines of:

- it is in the best interests of the borrower to refinance so that they can take advantage of a lower interest rate or other offer (such that cost of lending is decreasing);
- there is no increase in overall lending;
- the borrower has had no adverse change in income (and this can be verified);
- the borrower confirms there have been no other adverse changes in financial position.

The purpose of including this example is to show that, in circumstances where a borrower is not at risk of suffering substantial hardship, the CCCFA should not operate as a barrier to customers seeking more favourable outcomes from another lender.

Amendments to Regulations

Amendment to Regulation 4AE

We support removing ‘savings’ and ‘investments’ as types of ‘listed outgoings’ in Regulation 4AE.

However, to achieve the policy intent, we have provided drafting suggestions (and rationale for these suggestions) in the Appendix.

Amendment to Regulation 4AK(2)(b)

We support the intention behind the amendment to 4AK(2)(b), to ensure the duty to capture information in sufficient detail is limited to instances where the lender asks the borrower for relevant expenses information under Regulation 4AK(2)(a)(i). However, to achieve the policy intent, we have provided drafting suggestions (and rationale for these in the Appendix).

Appendix: Drafting Suggestions

Regulation 4AE

Simply removing the references to those items from the examples listed in paragraph (d) of the definition is unlikely to go far enough in ensuring that lenders do not capture ‘savings’ and ‘investments’ as expenses. To the extent ‘savings’ or ‘investments’ still fall within the definition of ‘any regular or frequently recurring outgoings’, they could still be caught.

We suggest either expressly excluding ‘savings’ and ‘investments’ or replacing the term ‘outgoings’ in (d) with ‘expenses’.

To achieve the policy objective, the definition of ‘listed outgoing’ should expressly exclude ‘savings’ and ‘investments’. For example:

> ‘**listed outgoings**:
>
> (a) means any of the following:
>
> (i) fixed financial commitments…
>
> (ii) payments of any debts…
>
> (iii) living expenses…
>
> (iv) any regular or frequently recurring outgoings (for example, ~~savings, investments,~~ gym memberships, entertainment costs, or tithing) that are material to the estimate of relevant expenses and that the borrower is unable or unwilling to cease after the agreement is entered or materially changed; and
>
> (b) does not include any savings or investments.’

Another option would be to support the removal of references to ‘savings’ and ‘investments’ in paragraph (d) by replacing the term ‘outgoings’ in that paragraph with the term ‘expenses’. For example:

> ‘**listed outgoings** means any of the following:
>
> (a) fixed financial commitments…
> (b) payments of any debts…
> (c) living expenses…
> (d) any regular or frequently recurring expenses…’

Regulation 4AK

However, the current drafting may not achieve this intention as it may require a lender to capture information in sufficient detail where Regulations 4AK(2)(a)(ii) or (iii) are used, if the lender has asked the borrower about *any* expenses under Regulation 4(AK)(2)(a)(i).

To achieve the policy objective, we suggest Regulation 4AK(2)(b) should read:

> ‘ensure that where a lender asks the borrower about any relevant expenses under Regulation 4AK(2)(a)(i) they do so in sufficient detail to minimise the risk of relevant expenses being missed or underestimated to an extent that is material to the initial estimate’

Or, a simpler approach may be to remove Regulation 4AK(2)(b) and amend Regulation 4AK(2)(a)(i):

> ‘asking the borrower about their relevant expenses in sufficient detail to minimise the risk of missing or underestimating those expenses to an extent that is material to the initial estimate’.

We also note that a further amendment should be made to Regulation 4AK(2)(a)(i) to change the reference to ‘relevant expenses’ to ‘likely relevant expenses’.

The Code – Paragraph 5.5

We suggest replacing paragraph 5.5 with the following:

> ‘Regulation 4AF requires lenders to consider the borrower’s *likely relevant expenses*, which are those *relevant expenses* the borrower will over the *relevant period*, which is after the borrower takes out the loan.
>
> A lender should only include expenses the borrower will have after taking out the loan.
>
> A lender can omit an expense from their initial estimate where clear in the circumstances the expense will stop. For example, if the borrower is borrowing to buy a home they will live in, then the lender can omit any existing expenses for renting.
>
> A lender can also check with the borrower if a change is likely to any expenses. For example, if a lender believes it likely entertainment or clothing expenses may reduce after taking out the lending.
>
> Where a borrower says they’re willing or can stop an expense (before taking out the loan or later, if needed), a lender should not include that expense in their initial estimate under Regulation 4AK.
>
> The lender can rely on what the borrower tells them will happen with their expenses. The lender does not need evidence the expenses will or have stopped or reduced.

Where a lender uses statements to create the initial assessment, the lender should still consider how the expenses in the statement may change. If the lender needs to clarify with the borrower which expenses should be excluded or adjusted, the lender is merely confirming the amounts to be used under Regulation 4AK(2)(a)(ii). Asking the borrower in that situation does not trigger Regulation 4AK(2)(a)(i).’

The Code – Paragraph 5.6

We suggest replacing paragraph 5.6 with the following:

> The intent of Regulation 4AK is to capture the borrower’s likely relevant expenses after taking out the loan.
>
> A borrower may change their spending behaviour after taking out a loan, changing their existing expenses. So, lenders can prompt customers to consider how those expenses will change, and only include expenses that are likely to exist over the relevant period in their initial estimate, including when using statements.
>
> When a lender is collecting living expenses under paragraph (c) of the definition of ‘listed outgoings’ in Regulation 4AE, then the lender should distinguish between basic necessities and discretionary spend. The lender only needs to capture basic necessities, being the *basic essential expenditure* and *basic quality-of-living costs of the customer’s household*. These are expenses the borrower can’t forego or would find hard to reduce beyond a certain point, and give a basic quality of life.
>
> For example, a borrower’s food expenses include regular dining out or take-away expenses the borrower is prepared to reduce or stop by eating at home more often.’

In considering what expenses to include under paragraph (d) of the definition of 'listed outgoing' in Regulation 4AE, a lender should only include expenses if the expense is:

(a) ongoing and will last during the relevant period
(b) not discretionary – the borrower would not or could not stop the expense if there is a need to (before entering the loan or later, if needed), and
(c) material or significant financially to the affordability assessment.'

A lender only needs to clarify whether the borrower *would* or *could* stop an expense if needed, not they will or have done so.

The Code – Paragraph 5.8

We suggest amending paragraph 5.8 by deleting 5.8(c).

The Code – Paragraph 5.19

We suggest replacing paragraph 5.19 with the following:

A lender may choose to apply a reasonable surplus, or buffers and adjustments, or both to meet Regulation 4AF.
(a) Regardless of the approach the lender chooses, the purpose behind requiring a reasonable surplus or buffers and adjustments is the same.
(b) Any reasonable surplus applied, and any buffers or adjustments applied, must be capable of addressing the risk of overstating income or materially understating expenses..
(c) A lender may apply one or more types of buffers and adjustments in their lending assessment processes.
Lenders may apply their buffers and adjustments or reasonable surplus at a product level or on a risk basis.

For example,

A lender will have adequate buffers and adjustments to meet the requirements in Regulation 4AF if the lender's credit policies require the following, where relevant to a particular affordability assessment:

(a) use of a sensitised interest rate
(b) discounts to volatile, irregular, or variable income, and
(c) comparison of benchmarkable expenses against benchmarks.'