大成 DENTONS KENSINGTON SWAN

Resources and Markets Ministry of Business, Innovation & Employment

By email: consumer@mbie.govt.nz

Submission on Consultation Paper – CCCFA Amendment Regulations and Responsible Lending Code

This is a submission by Dentons Kensington Swan on the Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022 and updated Responsible Lending Code Consultation Document dated September 2022.

1 About Dentons Kensington Swan

Dentons Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Wellington and Auckland. We are part of Dentons, the world's largest law firm, with more than 12,000 lawyers in over 200 locations.

We have extensive experience in financial services law issues, with a specialist financial markets team acting for established major players as well as niche providers and new entrants to the market. We assist a number of financial institutions with their regulatory obligations and conduct and culture initiatives. We regularly advise on Credit Contracts and Consumer Finance Act 2003 (CCCFA), Personal Property Securities Act 1999, financial markets legislation, the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 and financial advice regulations and legislation.

2 General comments

We refer to the Council of Financial Regulators' 'Early implementation and impacts of the December 2021 credit changes Investigation Report', and the option considered within to further consider the targeting of the affordability regulations to either specific types of lending or lenders. Although the option was considered but not recommended by Minister of Consumer Affairs, David Clark, to Cabinet, we believe the option has merit and should be reconsidered. By specifically targeting the affordability regulations to risker lending and lenders this would direct the focus on helping vulnerable borrowers who are most at risk by ensuring there are minimum prescribed standards. It would also mean responsible lenders would more confidently be able to make credit more available to borrowers who are able to afford it. In particular, lenders who are already regulated by the Reserve Bank, such as registered banks, are already subject to numerous prudential and other regulatory and conduct compliance obligations. Because of this, they already have established loan approval processes for products such as residential home loans in place. The affordability regulations add an additional compliance burden for registered banks that would not result in any meaningful upside or protection for a borrower in addition to their established loan approvals processes.

In the absence of not targeting the affordability regulations to specific lenders and riskier types of lending, the current proposed amendments to reduce the number of inquiries a lender is required to make for an affordability assessment and broadening the scope of lender discretion is a positive step. However, we believe instead of implementing more incremental changes, the amendments to the regulations should go further in moving towards a principle based approach for lenders, and in particular for registered banks. We believe by adopting a general principles based approach and allowance for discretion to be used by a responsible lender, lenders (and especially registered banks) will continue to adopt a conservative approach to credit which will restrict lending activity and borrower access to credit given the onerous CCCFA penalties regime.

Our responses to the below submission questions below have been made in the context of our general views above.

3 Questions

3.1 *Do you agree with amending the definition of 'listed outgoings' along the lines proposed? Do you have any comments on the wording of these changes?*

We support of the exclusion of savings and investments as treatment in the definition of 'outgoings' would otherwise be incongruous and potentially act as a disincentive to borrowers who also want to practice saving and investing. The deletion of the example references to gym memberships and entertainment is logical given the new proposed paragraph (aa) to the 'relevant expenses' definition.

3.2 *Do you agree with amending the definition of 'relevant expenses' along the lines proposed? Do you have any comments on the wording of these changes?*

We appreciate the difficulty in finding a balance between affordability, hardship and borrower access to credit when defining 'relevant expenses' while ensuring there are sufficient minimum standards in place to protect borrowers, and at the same time also allow some flexibility for responsible lenders in determining relevant expenses.

Considering the above, the exclusion in paragraph (aa) is welcome. The threshold for the decision in relation to determining discretionary expenses eligible for the exclusion to what 'a responsible lender would reasonably expect' is set at the right level of flexibility and supports a principles based approach, whilst still recognizing the importance of 'substantial hardship' analysis. The allowance for flexibility should assist in making the regulations more fit for purpose and workable in practice. We note this approach means the NZ position would also be better aligned with the approach taken in Australia under its National Credit Code.

3.3 *Which of the two options for guidance in the Draft Code relating to treatment of discretionary expenses is most appropriate and why? Do you have any comments on the wording of either of these options?*

We support the guidance outlined in Option 2 of the draft Code as it aligns with a broader principles based approach, but still has built in the fallback of requiring the defined discretionary expenses to be initially captured by lenders. It is appropriate a responsible lender should still be expected to make additional inquiries as to discretionary expenses, but only when they have reason to believe their assumption is not correct. Generally, a responsible lender should be able to rely on a declaration of expenses (including discretionary expenses) from a borrower. We do not support or regard it as appropriate for a lender to itself make decisions as to what borrower expenses are 'at significant risk of not being discretionary' as contemplated under the Option 1 wording. The Option 1 wording would not adequately address or alleviate the current longer processing times borrowers are experiencing for credit applications due to the increased number of inquiries now necessary for lenders to undertake.

3.4 *Do you agree with the approach to excluding some credit cards as proposed in regulation 4AL(2A)? if not, what changes would you make?*

Generally, we support the exclusion of some credit cards which allows sufficient discretion to allow lenders to consider individual circumstances with a practical degree of flexibility. It would be better if the wording in paragraph (b) allows for some discretion so a lender "has no reasonable grounds to believe the borrower will incur interest ..", as otherwise it could result in an overly conservative approach from lenders and for further unnecessary inquiries to be made.

3.5 *Is any additional guidance needed for the exception in 4AL(2A) for certain credit cards? If so, what should this guidance state?*

We suggest more tailored practical guidance as to how a lender can decide whether the scenario in 4AL (2A)(b) applies. It should be appropriate for a lender to be able to rely on the information provided by a borrower, including whether the intention is for interest to be incurred without necessarily inquiring further. A responsible lender should be able to make this decision based on the information provided to it, unless it there are reasonable grounds to believe such information is incorrect, in which case further inquiries should be made.

3.6 *Do you agree with explicitly excluding BNPL in its entirety from 4AL(2)? If not, are there alternative ways, that would be workable for lenders, to impute future BNPL expenses based on a borrower's existing BNPL facilities?*

We have reservations with the proposal for BNPL expenses being expressly excluded from 4AL(2). We note a definition of BNPL is to be included in the finalized regulations. The scope of the definition will need to be closely considered as BNPL products are constantly innovating and are usually at the regulatory margins.

Anecdotally we have become aware of BNPL being increasingly offered for a greater range of goods, extending into essential living requirements such as clothes and food. At the same time, some clothes and food could also be discretionary expenses. We assume BNPL payments for non-discretionary clothes and food expenditure should not be subject to the exclusion as instead payments for these (assuming no interest or other fees become payable) would more appropriately fall under the definition of listed outgoings. Alternatively, a cap on the total amount of future BNPL expenses could be considered. If the expenses went beyond the cap, then the exclusion would not apply.

We recognize there is a delicate balance to be struck when determining exceptions, but we consider a blanket BNPL exclusion may have unintended consequences. It is possible potential borrowers may enter into more BNPL products than they would have normally because of the exclusion on an understanding BNPL expenses would not count for affordability assessments. This may disproportionately impact on potential borrowers who are more susceptible to vulnerability or exposed to unscrupulous lenders. Instead, we support a principles based approach to allow a lender to make its own assessment (after making reasonable inquiries with the borrower) as to whether potential future additional BNPL expenses (e.g. interest and fees) are or are likely to become applicable when assessing expenses. For example, a responsible lender should be able to make a distinction between a borrower who has entered into numerous BNPL contracts and/or regularly enters into BNPL contracts which together amount to a relatively material amount of potential liability (in the context of that borrower's income/expenses), as opposed to borrower who only rarely uses BNPL contracts which amount to a relatively immaterial amount of potential liability.

3.7 *In light of excluding BNPL from 4AL(2), is any further guidance in the Code necessary to address the treatment of BNPL expenses? If so, what should this guidance state?*

See above regarding our position on the proposed exclusion. Depending on the approach taken to BNPL, the Code should provide further guidance given the existing 5.34 is limited in scope. Paragraph 5.34 should be expanded to clarify there should not be double counting for a scheduled ordinary debt payment which is BNPL if the goods subject to the BNPL arrangement has already been provided for as a listed outgoing.

As per our comment in 3.6 above, given BNPL products are fast evolving, Code guidance as to the minimum requirements to meet the definition would be useful as not all BNPL will necessarily be 'vanilla' in nature. To the extent the BNPL definition allows for some flexibility, there should be appropriate guidance so lenders are able to identify the parameters of the definition practically and clearly.

3.8 *Do you agree with the way that the Draft Regulations relating to the expanded exception for variations and replacement of existing credit contract is phrased? If not, what changes would you make?*

We agree in principle with the expanded exception for variations and replacements of existing credit contracts, however for the reasons given in our comments in 3.9 below we favour a more principles based approach for lenders when applying the exception to allow for flexibility, for example this could also cover refinancing for emergency situations.

3.9 *Which of the two drafting options for expanding the exception for variations and replacements of existing credit contracts would be most workable and why?*

For Option 1, the simple requirement for monthly repayments to be equal or lower under the existing credit contracts is a blunt test. In our view it is inconsistent with the new more prescriptive approach for affordability and suitability in the Regulations. As drafted, it may be an untended consequence under Option 1, borrowers may opt for the maximum loan term of 30 years to come within the option and thereby reduce their monthly repayments, but overall, they will be worse off as the overall cost of credit may be greater and be prolonged over a longer repayment term.

Option 2 may seek to provide for more nuance and discretion for the exception to apply, but at the same time it prescribes the calculations to be made. We consider Option 2 to be unduly prescriptive and may result in the unintended consequence of the affordability and suitability process being more cumbersome.

We would instead support a more principles based approach to the exceptions for a refinancing. For example, an increase to an existing credit contract for the same amount or increased amount up to a certain threshold (for example, 10% of the initial principal amount) could qualify, or where there are emergency situations which arise to necessitate an increase to reduce financial difficulties the borrower may be experiencing or reasonably expects to experience. In either example, the borrower could confirm whether there were material changes to its income and outgoings to when they were last provided, and the lender could rely on this provided it has no reasonable grounds to believe such confirmation is incorrect or is aware of other factors which may indicate the refinancing would not otherwise be affordable and suitable.

Although we believe a principles based approach should be taken rather than either Option 1 or 2, in in the absence of a principles based approach, we would favour Option 1 over Option 2 for the reasons set out above.

3.10 *Do you agree with the suggested guidance in the Draft Code relating to the expanded exception? If not, what changes should be made to the Draft Code guidance?*

If Options 1 or 2 were to be applied, we do not have comments on the additional guidance suggested in 5.43 of the Code.

3.11 *Would any of these changes require changes to lender systems before they could come into force? If so, what are the likely timeframes for making these changes?*

Given the proposed changes will affect existing lender processes for affordability assessments, a lead in period will be needed so lenders can assess what changes to their existing processes will be required. There are also likely to be consequential review and/or changes needed by lenders for other CCCFA processes and policies. For large institutional lenders such as banks, these are likely to take a minimum of 4 to 6 months to operationalize and ensure adequate training of staff has been undertaken.

4 Further Information

We are happy to discuss any aspect of our feedback in our submission. Thank you for the opportunity to submit.

Yours faithfully

Pauline Ho
Special Counsel
Dentons Kensington Swan
Privacy of natural persons