FinCap
Got it together

Level 6, 330 Lambton Quay
PO Box 25332 (Featherston Street)
Wellington
Email: info@fincap.org.nz
Phone: 04 471 1420

www.fincap.org.nz www.facebook.com/fincapnz

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Consumer Policy Team
Building, Resources and Markets
Ministry of Business, Innovation and Employment
Wellington

RE: Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022 and updated Responsible Lending Code Consultation Paper

Whānau should not face a position where lending that was always going to be unaffordable causes or compounds hardship. The onus must be on lenders to not disregard that collection on due repayments is likely to cause harm.

FinCap welcomes the opportunity to comment on the Ministry of Business, Innovation and Employment (**MBIE**) *Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022 and updated Responsible Lending Code Consultation Paper* (**Consultation Paper**).

Overall, we are concerned that the implementation of these policy changes could permit some lending that was always unaffordable and in doing so create avoidable financial difficulty and stress for whānau as well as extra work for financial mentors. We urge MBIE to be extremely careful and ensure the changes to the regulations or Responsible Lending Code (**Code/guidance**) are drafted so there is still an onus on lenders to consider the unique circumstances and objectives of a potential borrower and to respond responsibly once this information is gathered. Such requirements will avoid giving the 'green light' to irresponsible lending.

We expand on these comments in the submission below.

About FinCap

FinCap (the National Building Financial Capability Charitable Trust) is a registered charity and the umbrella organisation supporting the 200+ local, free financial mentoring services across Aotearoa. These services support more than 70,000 people in financial hardship annually. We lead the sector in the training and development of financial mentors, the collection and analysis of client data and encourage collaboration between services. We advocate on issues affecting whānau to influence system-level change to reduce the causes of financial hardship.

General comments

Whānau who are facing financial difficulty because of unaffordable lending after December 2021 are now presenting for assistance from financial mentors. Financial mentors are telling us that they are using the Credit Contracts and Consumer Finance Act (**CCCFA**) in their work every day when walking alongside whānau on pathways away from financial difficulty. FinCap has heard of lenders quickly waiving sums or unwinding non-compliant contracts when information is requested or when a complaint is lodged with assistance from a financial mentor and this ceasing a debt spiral. One service offering financial mentoring has shared figures with FinCap showing that in 2022 alone their financial mentors have used safe lending laws to help whānau cancel $180,000 in loans and have $105,000 of funds returned to whānau. They say this work is the tip of the iceberg of how the reformed CCCFA can help whānau get back on track from financial difficulties.

We have also heard reports from financial mentors of some lenders changing their conduct for the better while we anticipate other lenders are not far from facing enforcement over breaches of the new rules based off the clear grounds mentors have had for complaining about them. Our safe lending laws are starting to work and we need them to remain robust so that they prevent unaffordable lending that is harmful to our communities in the first place.

Through this current round of consultation on the CCCFA and the processes leading up to it there has been commentary from some of a tension between instructions to ensure adequate consumer protection around the risks associated with lending and instructions to reduce perceived 'intrusiveness' of inquiries for some borrowers. FinCap asserts that lenders gathering information in good faith to ensure they are not providing unaffordable lending is not intrusive. A lack of skill around respectful customer service might have caused issues but the requirements in regulations are not the issue with this, rather it is an issue with a lender's culture.

Any whānau can find themselves in financial difficulty due to risks they have not yet identified but that could be spotted by a responsible lender. How people go about their finances is often unique. It is important that lenders check they understand the position a borrower will likely be in after a loan is advanced and effectively communicate any assumptions made with the borrower, especially if material to affordability. Robust protections for all should not be dropped simply because of slight inconvenience to some and FinCap continues to call for safe lending laws with strong enforcement, where a borrower and their financial mentor can turn around the harm done by unaffordable lending.

If anything, patterns of a few gaps in protections are emerging and indicating the need to further strengthen the protection framework or the need for enforcement to keep protections robust. In particular, many financial mentors have noted a lingering debt following the repossession and sale of a vehicle where a dispute resolution service has found that the original lending was unaffordable. We request changes whether at guidance, regulation or legislative level or through enforcement work to ensure borrowers receive the appropriate remedy of having all payments returned and no outstanding balance. Borrowers should be returned to the position they were in before lending that breached requirements around assessing affordability.

Recommendation: Decision makers in current and future Governments maintain and continue to strengthen our current Credit Contract and Consumer Finance Act safe lending laws so that:

- Financial mentors and other community workers have the tools to reverse harm caused by unfair lending that was always going to be unaffordable.
- All lenders are better deterred from unfair and unaffordable lending that would lead to harm in our community.

Recommendation: MBIE work with the Code Advisory Group to establish the most direct way of ensuring whānau are not left with unfair residual debt from lending that was in breach of the CCCFA in the first place and to add any other guidance to clarify issues with interpretation that have practically meant gaps in protections since December 2021.

Responses to specific Consultation Paper questions

Question 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?

FinCap regards the change to the definition of 'listed outgoings' as creating a significant risk. By specifically removing 'gym memberships' and 'entertainment costs' as examples in the explanation of 'regular and frequently recurring outgoings' the risk of expenses being easily misclassified is increased.

We recommend that in order to minimise the risk that these changes allow for, the regulations must be accompanied by 'Option 1' (at paragraph 5.9) of the guidance options. There is a risk that there will be a blanket exclusion of entertainment costs and gym memberships, because of the presence and then deletion of these within 4AE(d). These expenses carry a high chance of being fixed expenses and there is a risk of giving a green light to these costs being ignored by lenders. The proposed drafting of new guidance in 'Option 1' is crucial to ensure that lenders clearly understand that these items are potentially fixed financial commitments for some borrowers, where there are contractual obligations or break fees associated with the expense.

Considering the importance of accurate affordability assessments, the wording of these changes is critical. Financial mentors have noted that often expenses such as gym memberships and entertainment costs are truly essential costs for a whānau, because of their personal circumstances.

Recommendation: MBIE when drafting to implement changes removing checks around truly discretionary expenses, specifically require lenders to consider what is, and is not, discretionary in each individual circumstance.

Question 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?

The addition of (ab) under 'relevant expenses,' as described in the Consultation Paper, clearly signals that discretionary expenses are to be excluded from estimates. FinCap strongly recommends that there continue to be drafting under the definition of 'relevant expenses' due to substantial risks of non-discretionary expenses being misclassified and resulting in lending that is harmful to whānau.

The wording of this change in the regulations appears to allow for lending to be the cause of financial hardship, rather than focusing on whether the borrower is able to make repayments while still having their wellbeing maintained. Financial mentors are currently seeing affordability

assessments that have no acknowledgement of expenses that are material to the borrower's ability to live their life. Please refer to the additions below in *question 3* of this submission for examples of the expenses that are repeatedly left off affordability assessments and therefore require further guidance.

We have heard commentary that some lenders use buffers and surpluses in lieu of exploring the nuances of the relationship with money that each whānau has. We would be alarmed if regulatory requirements went down a path of only considering the costs of bare necessities to maintain basic physical health with a buffer or surplus used for everything else. Buffers or surpluses should be there to be used to reduce the risk of underestimation of expenses that can change, not just be put in place in proxy for counting expenses not explored by the lender.

We also see a risk with the timeframe in which borrowers are expected to cease an expense that is interpreted by the lender as being discretionary. There are multiple areas of risk within this. Firstly, where the expense relates to a factor such as addiction, mental health or physical health, there may be quite real and practical issues with an expectation to cease an expense within a short period of time. We recommend that MBIE seek advice from professionals in the health care system to understand what considerations are critical for timeframes where addiction may be a factor. Furthermore, habitual spending more generally takes time to change in reality and there is a particular risk where lenders are not communicating expectations or assumptions around a potential borrower's future spending clearly.

Another crucial issue, and one that connects to the above point about timing, is the communication from lenders to borrowers. Clear and accurate communication with the borrower is critical. Borrowers need to be made aware, and genuinely understand, that they are receiving a loan on the understanding that there is an expectation of 'discretionary' expenditure being stopped. There must be clear communication from lenders that they have excluded particular expenses on the basis of them being classified as discretionary, and what this means for the borrower. Where a lender may expect that the borrower ceases their discretionary expenditure in order to afford the loan, there must be clear and accurate communication to the borrower.

Effective communication is a core factor in ensuring safe lending. Some lenders have criticised the current regulations and guidance, saying that discussions around expenditure with potential customers can be a point of tension. From the observations of FinCap and financial mentors, there seems to be an issue with judgemental communication from lenders' staff that is inappropriate. We regularly hear anecdotes of (and at times extremely) disrespectful comments from all types of lenders' staff about spending when financial mentors are negotiating hardship arrangements. It is therefore unsurprising that this might be occurring at the start of a loan too. An example might be callous comments about spending relating to addiction issues that stem from long term disadvantage or comments about a mistake made in spending while under significant pressure from overlapping social issues or a life event.

Recommendation: MBIE, when drafting to implement the removal of truly discretionary expenses from 'relevant expenses' should ensure that the onus is on lenders to meet a high threshold of establishing reasonable expectations around what is, and is not, discretionary in each individual circumstance.

Recommendation: Add under 4AE a definition of discretionary expenditure to minimise the risk of lenders ignoring expenses that they assume to be discretionary due to their own world view.
We recommend drafting along the lines of the following be considered as a definition of truly discretionary expenditure:

Expenses that the borrower has complete agency to cease without significant detriment, meaning the expense is not interacting with:

- *a) Rules, whether contractual, social, cultural, or moral obligations*
- *b) The physical or mental health, and wellbeing of the borrower*
- *c) The wellbeing of that borrowers whānau, dependents and pets*
- *d) Social and cultural connectedness* [1]

This clarification should ensure that the onus is on lenders to check that borrowing is affordable for each individual borrowers' circumstances, and so that lenders cannot ignore expenses that are material to the wellbeing of the borrower. For example, a borrower may have a gym membership as part of recovering from an injury that stops them from being able to run outdoors due to impact. Therefore, their gym membership is an essential cost as it funds their physical and mental health.

Question 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 the options?

Of the two options proposed in the Draft Code, FinCap firmly prefers 'Option 1' (at paragraph 5.9). As previously referred to, we are concerned about the risk of non-discretionary expenses being categorised as discretionary and potentially causing harm to the borrowing whānau. 'Option 1' provides a clearer framework for mitigating these risks. Every whānau and individual borrower has unique and special circumstances, and therefore their requirements for safe lending are also unique. 'Option 1' better ensures that lenders take each individual borrower's circumstances into account and are aware of the risk of misclassification.

We recognise several considerable problems with 'Option 2' (at paragraph 5.10) of the Draft Code and strongly recommend that this option is ignored. 'Option 2' provides room for lenders to automatically exclude items that are not included in the 'listed outgoings' list. Although there is the addition of pets into category d) and further clarification on the issue of break fees and contractual obligations, these are limited. The risk here is that lenders can too easily misclassify items as discretionary, a risk that the Consultation Paper has identified. We are concerned that lenders are not going to accurately capture the expenses that borrowers have and therefore result in unsafe lending that causes harm to whānau.

While we prefer 'Option 1,' we identify several key risks. Firstly, with the wording explaining that when an expense is included in the initial estimate is material to the lending decision, then the lender <u>may</u> make inquiries into the expenses that are at risk of being non-discretionary. Where the decision to lend or not relies solely on an expense that is at risk of being non-discretionary, there should be a clearer obligation that the lender confirms that the expenses are truly discretionary with the potential borrower.

Furthermore, we recommend that there are further expenses added into the list of considerations that lenders should make. These are items that we have regularly heard from financial mentors are left off affordability assessments but are important expenses. We have noted these below. Under 5.9 "lenders should have regard to the following assumptions", we propose that the following additions are made:

- Parking can be paid annually or regularly and must be factored into transport costs (4AE c)

[1] See Collins Dictionary definition of discretionary - https://www.collinsdictionary.com/dictionary/english/discretionary

- Healthcare is absolutely a non-discretionary expense and must be factored into an affordability assessment accurately.
- Borrowers may often have multiple buy-now-pay-later (BNPL) loans that are difficult to keep track of and to remember when and what costs are going out. As responsible lenders, there should be particular attention given to what BNPL repayments are being made.
- Presents are likely non-discretionary. Expenses for presents are often important for the social and cultural participation, connectedness, and obligations of the borrowing whānau. For example, financial mentors have observed instances where a child is invited to a friend's birthday party, and this has resulted in the parents facing substantial hardship to ensure they can participate and bring an appropriate present.
- Clothing is a personal living expense (4AE c).
- Expenses related to an addiction must be treated with care, and responsible lenders should understand that there are significant risks with expecting a strict timeframe for these being ceased.
- Potential misclassification of spending relating to allergies as discretionary food expenditure.
- Children's pocket money can be an important educational tool.
- Regular haircuts might be a requirement for current work or while seeking employment.
- Costs related to the need for glasses may not appear on 90 days of bank statements, although fashion related to glasses may be discretionary, the fundamental need for them is not. Furthermore, the costs for these can vary greatly depending on prescription.

The above expenses are ones that financial mentors have noted as being regularly misclassified or even completely missed off affordability assessments. Each borrower has a different priority ranking for expenses that are important to them. Whānau can end up not eating while they try to pay for expenses that are most important to them at a given time and stage in their life. When lenders do not practice the appropriate level of care and skill when classifying items on an affordability assessment, it can reinforce this risk of a borrower forgoing essentials to maintain expenses that were not acknowledged.

Having insightful conversations with a borrower is important for assessing their genuine priorities and expenses. Financial mentors have strengths based, non-judgemental conversations with people about money every day and regularly recommend from their observations that creditors should have guidance on strengths-based communications. We put this forward as something that could be added to the Responsible Lending Code.

Recommendation: Strengthened drafting. along the lines of 'Option 1' in the Consultation Paper should be implemented by MBIE to realise the instructions for change. This style of drafting acknowledges that the circumstances of borrowers are unique and this needs to be considered by all lenders when deciding what is truly a discretionary expense. The time within which a borrowers may be able to cease or reduce a particular expense may also vary and must be accounted for.

Question 4. Do you agree with the approach to excluding some credit cards as proposed in 4AL(2A)? If not, what changes would you make?

Lending where an existing high revolving credit limit that if taken out suddenly would be unaffordable in itself, or material to the affordability of subsequent lending appears to be permitted by the current drafting. This could lead to a debt spiral and hardship that was completely avoidable.

To prevent putting whānau at additional risk, MBIE should refine their drafting so that this change only permits lenders not 'double counting' everyday expenses run through a credit card where they can evidence that they have established this is truly the case.

In general, FinCap is concerned that the consequence of this change will be instances of unaffordable lending that are not in breach of the CCCFA and leave whānau stuck in financial difficulty. We have spoken to stakeholders who have shared frustration about the way lenders extended their personal credit card limit seamlessly but then made it much more difficult to lower the limit.

Such lingering but usually unused limits are risky where material to the affordability of everyday life or further lending. Financial mentors often point to a cohort of whānau seeking support who suddenly change their approach to finances and access unaffordable credit when faced with a life event. Examples could be the death of someone close, relationship breakdown or a sudden diagnosis of serious illness that mean whānau are under pressure to navigate a completely new, overwhelming and rapidly changing set of financial decisions.

We are also generally alarmed that a decision has been made to potentially weaken our safe lending laws to accommodate a particular credit card product that it appears lenders provide either:

- in the hope that someone will end up unable to pay and incur significant fees, or
- as a marketing incentive to otherwise invest or borrow from that institution.

While some inconvenience may be faced by some whānau using these facilities through lenders meeting the requirements of regulations as at December 2021, such a trade-off will have been for the more significant benefit of having prevented the creation or compounding of hardship and harm for other whānau. Such hardship and harm can cause the debt spirals that contribute to or compound social issues across generations and this will have been avoided. We also point that lenders have some further guidance to utilise to avoid such inconvenience in situations where it is obvious lending is affordable and the limit on a credit card is not relevant through the exception for regulation 4AF in regulation 4AG.

In the current proposed drafting we are concerned that the last 90 days of transactions may not reflect ongoing behaviour or expenses that are annual in frequency such as car maintenance that might have taken almost 9 months to pay off on a credit card. We do however welcome the proposed 4AL(2A) A.b. drafting which appears to require lenders to have "*…no reason to believe that the borrower will incur interest after entering…*"[2] While it is helpful in the regulation it will need additional guidance requiring lenders to appropriately discuss intentions with potential borrowers to provide an adequate consumer protection as we discuss in our response to the following question.

Recommendation: MBIE's drafting of regulations in response to instructions to stop the double counting of everyday expenses paid by credit card without incurring charges should be precise and not leave room for harmful lending that is unchecked.

Question 5. Is any additional guidance needed for the exception in 4AL(2A) for certain credit cards? If so, what should this guidance state?

As discussed above, FinCap recommends lenders are required to sufficiently establish expenses are being double counted before they are permitted to negate this issue in assessments. We support the proposed regulation drafting around lenders having no reason to believe a borrower will incur interest. We recommend extending the proposed guidance to ensure lenders are required to

[2] See page 5: https://www.mbie.govt.nz/dmsdocument/25114-2022-09-22-credit-contracts-and-consumer-finance-amendment-regulations-no-2-2022-consultation-draft-pdf

effectively inform potential borrowers that their credit card limit, if utilised, would-be material to the affordability of subsequent lending.

The commentary around a recent large purchase yet to incur interest in paragraph 23 of the Consultation Paper should be used as an example in the guidance.

We recommend more drafting is created in collaboration with the Code Advisory Group. This should see lenders guided to engage the borrower where the credit card repayments on the full limit are material to affordability to:

- Inform the borrower of the risk of default or hardship if interest is payable on the full credit card limit.
- Check the borrower knows their rights in relation to lowering the revolving credit currently available to them and how to action this or complain about any issues in actioning this.
- Check whether the borrower intends to change the way they utilise the revolving credit on a credit card within a subsequent relevant period where this could impact the affordability of further lending.

We also recommend guidance for lenders to specifically:

- Look out for signs that borrowers are already in an emerging debt spiral where funds are being transferred between multiple revolving credit facilities or from another credit contract to meet interest free periods in the short term.
- Be reminded that they should record evidence of how they sufficiently made inquiries to ensure there was 'no reason to believe' interest would be incurred on a credit card.

Such work on drafting more guidance to achieve the above will reduce the risk that the change to regulation to fulfil Cabinet's instructions leads to assumptions by lenders that systematically expose borrowers to substantial hardship. Situations should not emerge where a borrower is not aware that a lender has assessed that incurring interest on an existing credit card will likely lead to default or hardship from making payments with subsequent lending.

Recommendation: MBIE expand the proposed drafting in the Responsible Lending Code guidance related to the instructed change to avoid double counting of everyday expenses paid by credit card without incurring charges. This expanded drafting should ensure lenders are guided to ask about, and consider, each potential borrower's unique circumstances and whether charges will likely occur on the revolving credit card arrangements following additional lending.

Question 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?

FinCap strongly disagrees with the proposed exclusion of BNPL lending from considerations around revolving credit in these regulations. Over recent years we have heard regularly from financial mentors and other stakeholders that many BNPL lenders structure their apps as revolving credit facilities and regularly make unsolicited increases to the revolving credit available to those who borrow from them. The lenders themselves or their agents publicly discuss such 'spend amount' arrangements in websites FinCap has sited.[3]

[3] See for example: https://help.afterpay.com/hc/en-nz/articles/218320803-How-much-can-I-spend-with-Afterpay- (retrieved 18 October 2022)

We have heard frustration from both CCCFA compliant lenders and from financial mentors that unaffordable BNPL lending on top of compliant CCCFA lending is leading to default and financial hardship. We continue to strongly recommend that outside of this consultation, the Cabinet and the Minister for Commerce and Consumer Affairs urgently apply CCCFA protections to under regulated BNPL lending.[4]

We also observe that the under-regulation of BNPL is having flow on impacts to the Consultation Paper. Lenders covered by the CCCFA have little visibility as to the revolving credit available from some BNPL lenders. Borrowers from these lenders don't have control as to unsolicited 'credit limit' increases offered by BNPL lenders' apps. Our recommendation for BNPL lenders to be required to comply with the CCCFA could remove the need to overcomplicate regulations to work around BNPL lending.

Recommendation: The Minister for Commerce and Consumer Affairs and Cabinet extend CCCFA requirements to Buy-Now-Pay-Later lending to prevent the harm caused to the community by this lending. This would have the added benefit of avoiding unnecessary complexity or significant gaps in the proposed redrafting of CCCFA related regulation.

Where officials are still left without a clear indication of Cabinet's decision on BNPL lending regulation and continue to have to write wider regulation around these BNPL lenders avoiding CCCFA requirements we recommend additional drafting in section 4AL of regulations instead of the current proposed exclusion.

From examples shared by financial mentors we understand the risk of revolving credit from BNPL lenders being counted as a steady debt repayment rather than revolving credit involves two issues. One is that some BNPL lenders increase 'credit limits' and are incentivised to get customers to take up as much of the limit as possible to increase revenue from merchant fees. The other is that without affordability assessments before taking up more credit from a BNPL lender, a borrower is more likely to get stuck paying default fees for BNPL and be at greater risk of a debt spiral.

To counter the abovementioned risks we propose an alternative of additional drafting under 4AL that somewhat mirrors the proposed drafting for double counting of expenses run through credit cards. Such an alternative would mean that lenders don't simply ignore what could be a major issue.

Broadly we suggest regulations in 4AL permitting lenders to not consider BNPL as revolving credit only where:

1. Lenders have no reason to believe the borrower will incur additional borrowing to BNPL lenders beyond currently active contracts or will incur any default fees after entering a new credit contract that is being considered.
2. Lenders also are sure that the borrower has not previously increased the amount of BNPL borrowing (across one or more providers) or incurred any penalty for missed payments to such providers.
3. Lenders are also satisfied that current contracts for BNPL borrowing do not have credit limits available that are for amounts material to whether new borrowing would be affordable.
4. Lenders are also satisfied that the remaining length of contract on current BNPL lending is no longer than 70 days.

Taking this approach instead of excluding existing BNPL lending from 4AL (which would often wrongly assume this borrowing is static in its ongoing amount or that it will cease) will mean the

[4] Our submission on credit contracts currently evading appropriate consumer protections from December 2021 gives more context here: https://www.fincap.org.nz/submission-on-buy-now-pay-later/

regulation is closer to the reality reported by financial mentors of many BNPL lenders rapidly providing further unaffordable lending.

Recommendation: MBIE does not exclude BNPL lending from the revolving credit section of CCCFA related regulation but instead implements specific drafting to manage the risk related to this type of lending and implementing instructed policy changes.

Question 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?

Consistent with our above recommendations for MBIE's approach to the regulations, we recommend guidance mirroring, where relevant, our recommendations in response to *Question 5* and consistent with the regulatory approach we recommend in response to *Question 6.* It is important that the onus is on lenders to understand the revolving credit available to a potential borrower from BNPL lenders who are currently not required to complete an affordability assessment. Also, that lenders communicate the risk to the borrower of an available BNPL 'spend amount'/credit limit if it is material to the affordability of further lending.

Recommendation: MBIE drafts extended guidance in the Responsible Lending Code instructing lenders to obtain sufficient information to understand the nature of revolving BNPL lending available to a potential borrower. The guidance should also instruct lenders to establish whether additional BNPL lending has recently been extended to the borrower or whether they have recently incurred any fees related to such borrowing.

Question 8. Do you agree with the way that the Draft Regulations relating to the expanded exception for variations and replacements of existing credit contracts is phrased? If not, what changes would you make?

As discussed in a response below we are more in support of proposed drafting along the lines of 'Option 2' which is detailed in paragraph 32 of the Consultation Paper. If effective, this approach will only allow lenders to extend further credit where it is truly in borrowers' interests. Within that drafting we question whether *'is satisfied'* as is currently proposed or '*is satisfied on reasonable grounds*' as is often the standard applied in other areas of the regulations would hold lenders to a higher standard? We recommend that 'on reasonable grounds' is added to drafting if it does reflect a higher threshold for a lender establishing this is the case.

Overall, our discussions with financial mentors have revealed significant concerns that debt replacement for people facing hardship is often not suitable and that borrowers are left in a worse position. Financial mentors have shared observations that borrowers might seek a 'debt consolidation' believing this will prevent a current financial crisis. The borrowers then end up rushed through taking this up by a lender who has marketed such lending as relieving financial stress, only to then find they have just prolonged the financial issue. They noted that after credit contracts being replaced, they have seen instances of borrowers having less options for:

- Accessing assistance with payment difficulties on existing lending due to unforeseen hardship.
- Challenging irresponsible lending on the original lending where the payment difficulty caused by this unaffordable lending is the reason the borrower is seeking to replace credit contracts.

- Going through an insolvency process like a No Asset Procedure as credit contracts that were unsecured have been replaced by secured loans.
- Exploring social loan provider's relevant no interest loans that might be available.
- Taking up the help of a financial mentor to understand all the options available for moving forward.

However, on top of the significant risks noted above, some financial mentors have pointed out situations they have seen where there might have been merit to changes to 4AH. This generally was because it had become clear after thorough analysis that an option of replacing credit contracts to lower short-term cost could have better suited the goals of the whānau they were assisting with a potentially temporary cash-flow issue.

We have also had some discussions with workers at banks where there has been an indication that these institutions might take on the 'crystallisation' or consolidation of third-party debts where this might stop a debt spiral for a mortgage customer. With change there may also be less barriers for social loan providers to work with financial mentors to provide timely assistance to a whānau.

It would be great to see these opportunities become a reality when truly in the interests of a borrower but we again stress that individual circumstances and options available should be explored through the requirements in regulatory drafting to set a high standard. This change to regulation should not create an opportunity for lenders not truly acting in the interests of borrowers to grow market share while causing harm from unaffordable lending.

Recommendation: The drafting of regulations to allow a lender to replace a borrower's existing debt from other lenders set a clear onus on that lender to meet a high threshold of checking this lending will be better than alternatives. It is important borrowers are not prevented from accessing existing hardship assistance entitlements, insolvency options and available support from community workers. Any lending permitted by this change must ease rather than create or compound existing, or emerging hardship faced by the borrower.

Question 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?

As mentioned above we support a strengthened version of 'Option 2' for the drafting as this approach could require lenders to explore whether they are truly advancing safer credit. To strengthen protections we recommend that proposed drafting be extended so that lenders are required to establish a borrower has understood that there may be alternatives to replacing credit contracts where their purpose in doing so is to avoid financial difficulties. Drafting should also require lenders to offer appropriate referrals to take up these options.

Ideally, the replacement of credit contracts would include wider services before the agreement is entered where the potential lender informs a borrower seeking to avoid hardship that there are potential alternatives to explore. A referral to a financial mentor at this point could be a great intervention where the potential borrower and their whānau have the opportunity to better understand all options.

Financial mentors have also expressed concern at having seen situations where the replacement of a credit contract has gone ahead but the contract for revolving credit intended to be replaced has not ceased. This has caused issues like fees and interest that continue to incur and end up in collections when a borrower defaults on these 'hangover' payments. Otherwise, situations may arise where a

borrower makes use of both lines of credit in an emergency and ends up unable to service debts without facing substantial hardship. On this basis we recommend that lenders offering to replace third party credit contracts be required, through strengthening of the proposed regulation, to help a borrower in ensuring that the replaced contracts actually do cease.

Recommendation: Strengthened drafting along the lines of 'Option 2' in the Consultation Document be implemented by MBIE. The strengthening should realise instructed changes to allow debt replacement that is truly in the best interests of the borrower. This approach to drafting is preferable because it does not allow any further charges to a potential borrower without clear justification and accountability from lenders.

Question 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?

We agree with this as a starting point but urge more extensive requirements to ensure borrowers understand their other options when facing financial difficulty as consistent with the recommendations discussed in our responses above. We particularly would like to see guidance for a lender offering the replacement of third-party credit contracts to offer support to ensure those contracts cease.

We also recommend guidance to specify that someone is likely a vulnerable borrower when considering credit contract replacement to avoid hardship or financial difficulty. Ensuring those entering a credit contract understand the potential implications or have support to make a decision is crucial. Financial mentors have told FinCap they have observed that whānau who have already consolidated debt regularly report they felt under significant pressure when obtaining this credit. Also that when going into the borrowing, whānau did not understand that they would have been better off utilising exiting entitlements to statutory hardship and payment difficulty assistance or going through an insolvency process.

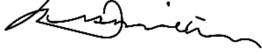
Recommendation: Proposed guidance in the Responsible Lending Code relating to proposed drafting for debt replacement be expanded to set a high standard for establishing that replacing existing consumer lending is truly in the best interests of the borrower. Where the purpose of replacing existing lending is to reduce or avoid financial difficulties then the Responsible Lending Code should note that the borrower is a 'vulnerable borrower' as discussed on page 98 of the Responsible Lending Code version revised June 2022.

Question 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?

While this question is focused on lenders, we note that financial mentors and other community support workers will likely need to put resources into understanding the changes and what was required, at what date, when assisting whānau to unwind unaffordable lending. Continuing to maintain or strengthen robust safe lending laws will reduce strain on the limited resources of the community organisations that help whānau clean up the mess caused by unfair conduct by lenders and other traders.

Please contact Senior Policy Advisor Jake Lilley on Privacy of natural persons to discuss any aspect of this submission further.

Ngā mihi,



Ruth Smithers
Chief Executive
FinCap