MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Andrew Bayly	**Portfolio**	Commerce and Consumer Affairs
Title of Cabinet paper	Progressing financial services reform	**Date to be published**	22 April 2024

List of documents that have been proactively released		
Date	**Title**	**Author**
19 March 2024	Progressing financial services reform	Office of Minister of Commerce and Consumer Affairs
19 March 2024	Progressing financial services reform EXP-24-MIN-0010 Minute	Cabinet Office
19 March 2024	Regulatory Impact Statement: Reducing the burden of affordability requirements in consumer credit legislation	MBIE

Information redacted	**NO**

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Regulatory Impact Statement: Reducing the burden of affordability requirements in consumer credit legislation

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced for the purpose of informing Cabinet policy decisions on reducing the impact of 'affordability' requirements in the Credit Contracts and Consumer Finance Regulations 2004*
Advising agencies:	*MBIE*
Proposing Ministers:	*Minister of Commerce and Consumer Affairs*
Date finalised:	*14 March 2024*

Problem Definition

The requirements in the Credit Contracts and Consumer Finance Regulations 2004 for assessing affordability of loans to consumers are overly prescriptive and disproportionate to the risk profile of lending in certain cases. This unnecessarily increases costs for lenders and borrowers and appears to be undermining access to affordable credit.

Executive Summary

One of the ways the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) protects the interests of consumers is by requiring lenders to be satisfied by reasonable inquiries that the loan will be affordable for the borrower. Regulations specifying minimum steps for conducting these inquiries came into force in December 2021 (the 'affordability regulations'). This was part of a suite of reforms intended to address concerns about continued irresponsible lending that appeared to be harming some borrowers.

Other notable reforms included increased liability for lenders and a requirement on lenders to keep records of the inquiries into affordability they have made (for sharing with the Commerce Commission, the borrower and Dispute Resolution Schemes if requested). There was no analysis at the time of the likely impact these reforms would have independently of one another.

In early 2022, MBIE investigated concerns that these changes, including the affordability regulations, were having some unintended impacts. We concluded that:

- more borrowers across all lending types who should pass the affordability test were subject to declines or reductions in credit amount
- borrowers were subject to unnecessary or disproportionate inquiries perceived by them as intrusive.

Despite some adjustments to the affordability regulations the Government made in response to these findings (in 2022 and 2023), they continue to impose a regulatory burden that is largely inflexible and, in certain cases, disproportionate to the likely risks to consumers. The consequences for lenders and borrowers cannot be addressed by non-regulatory options, such as providing further guidance.

Options for reducing the burden created by the affordability regulations have been confined by the responsible Minister to those that can be implemented straightforwardly and in a timely manner, in advance of changes to the CCCFA. Uncertainty created by this two-phased reform process increases the importance that options for amending the affordability regulations are clear and straightforward for lenders to implement. We shortlisted four regulatory options based on these constraints, which are analysed in this RIS:

- Option One: The status quo
- Option Two: Disapply the affordability regulations to lending by banks and non-bank deposit takers
- Option Three: Disapply the affordability regulations to home loans
- Option Four: Disapply the affordability regulations to lending with an annual interest rate below a certain threshold (using 15% and 30% thresholds as sub-options)
- Option Five: Revoke the affordability regulations and rely solely on guidance for lenders.

MBIE's preferred option is *Option Five: revoke the affordability regulations*. Lenders would still be required to make inquiries that are 'reasonable' and sufficient to satisfy them of affordability, and keep records of these inquiries. Rather than follow the minimum steps prescribed by regulations, they would have greater discretion to judge what inquiries are appropriate in each case (e.g. based on the risk profile of the lending). They would be supported to do this by non-binding guidance in the Responsible Lending Code.

Our preference for Option Five is not a particularly strong one. It reflects the fact we have greater confidence that this option, compared with the others, would create the conditions necessary for lenders to adapt the way they assess affordability to address the problems identified with the affordability regulations. We therefore expect it to be a relatively effective solution.

It has been challenging to weigh the expected benefits of this option against the risk of harm to consumers from unaffordable lending. This is the risk that lenders, in the absence of the affordability regulations, over-relax their methods for assessing affordability. Although Option Five elevates this risk more than other options, we judge the overall risk to be lower than prior to December 2021, when other protections were not available (notably, the requirement to keep records of affordability assessments and increased liability for lenders). We also believe this risk can be mitigated by effective guidance for lenders in the Responsible Lending Code, which we plan to develop as part of implementing this option.

Option Five would be supported by the full range of lenders, but met with relatively pronounced concerns from consumer advocates about a perceived diluting of protections for borrowers.

Limitations and Constraints on Analysis

We have a low to medium level of confidence in the quality of evidence available to inform this regulatory impact statement (**RIS**). This reflects general limitations in the evidence available to inform analysis of consumer credit policies. We have largely relied on data and qualitative evidence obtained from:

- a 2022 review led by MBIE, in collaboration with the Council of Financial Regulators, which investigated the immediate impacts of the affordability requirements that entered into force on 1 December 2021 within the Credit Contracts and Consumer Finance Regulations
- ongoing dialogue with key stakeholders about the impact of those requirements over time

- updated lending data (most of which is publicly available).

We have also recently obtained results from a consumer credit survey we procured concerning borrower experiences in the 2023 year. However, these results were not available in time to influence our analysis, and appear overall to be consistent with it.

The lending data available reflects a range of economic influences and cannot be used to make anything more than inferences about the impact of regulatory changes.

The 2022 investigation was focused on identifying intended and unintended impacts of the December 2021 CCCFA changes, and the range of options that could be considered to address any unintended impacts. As part of the investigation, MBIE conducted a series of semi-structured interviews with 32 stakeholder organisations. These included bank and non-bank lenders, mortgage brokers, associated industry organisations, and consumer advocates such as financial mentors. MBIE also spoke with credit reporting agencies and financial dispute resolution schemes. For lenders, the interviews included questions about their implementation process, impacts on customers, impacts on loan approval timeframes and rates, specific changes to loan approval processes as well as other concurrent factors. Following the interviews, MBIE asked stakeholders to provide more detailed information on the above in writing, including any specific proposals for changes to legislation and guidance. Data on lending was also gathered from the Reserve Bank, credit reporting agencies and individual lenders.

The findings of this 2022 investigation informed an earlier RIS advising Ministers of options to address the same problem identified above. Since the 2022 investigation, we have not been able to substantially improve our evidence base nor our understanding of whether the main benefits sought by prescriptive affordability requirements have been achieved. Successive Ministers have been focussed on addressing the unintended costs and regulatory burden created by these requirements.

Another constraint on our understanding of the actual impact of the affordability regulations is the fact they were among a range of reforms aimed at increasing compliance with lender responsibility principles. These interventions were not analysed independently in the original RIS, and their effects remain difficult to disentangle from the other regulatory changes (as well as non-regulatory changes affecting outcomes for borrowers).

The consequences of options considered in this RIS largely depend on the nature (particularly, the rigour) of affordability assessments different lenders can be expected to perform under each option. We have used the same evidence base described above to form loose expectations about these practices in future (which are to some extent commercially sensitive) and the likely impact of those practices on consumers. This evidence has limited predictive value.

We have undertaken targeted consultation with key stakeholders on the options considered in this RIS, which yielded little information about the likely consequences of each option. (Wider and more thorough consultation was not possible in the time available.)

Responsible Manager

Glen Hildreth
Manager, Consumer Policy
Ministry of Business, Innovation and Employment

13/03/2024

Quality Assurance (completed by QA panel)	
Reviewing Agency:	MBIE
Panel Assessment & Comment:	An internal quality assurance panel convened by the Ministry of Business, Innovation and Employment has reviewed the Regulatory Impact Assessment “Reducing the burden of affordability requirements in consumer credit legislation” and considers that the information and analysis summarised in the Regulatory Impact Assessment meets the Quality Assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The purpose of consumer credit legislation

1. The primary purpose of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) is to protect the interests of consumers in connection with various forms of consumer credit. Its secondary purposes include to promote the confident and informed participation by consumers and facilitate fair, efficient, and transparent markets for credit.

2. Markets for consumer credit are characterised by information asymmetries between lenders and borrowers. Even where consumers have good levels of financial literacy, they are seldom as well placed as the lender to assess how their interests might be affected by the combination of contract terms being offered, and compare this with other products that may be available to them. There are also certain cognitive biases and circumstantial pressures that can result in consumers making borrowing decisions that are not in their long-term interests.

3. The Commerce Commission is the agency with regulatory functions (including enforcement) under the CCCFA.

Shift in approach to protecting interests of consumers over time

4. Reforms to the CCCFA over time have generally been motivated by concerns about its effectiveness in fulfilling its primary purpose of protecting the interests of consumers (i.e. against problematic borrowing). They have tended to place greater responsibility and regulatory burden on lenders to act in the interests of borrowers. The following summary of previous reforms to the CCCFA illustrates this trend.

Short history of reforms to the CCCFA

When the CCCFA first came into force in 2005 (repealing and amalgamating the Credit Contracts Act 1981 and the Hire Purchase Act 1971), it mostly sought to protect consumers by:

- addressing information asymmetries through disclosure requirements (to promote informed borrowing decisions by consumers)
- providing consistent rules about how interest and fees are calculated and charged (to ensure they are not unreasonable)
- enabling borrowers to seek relief in contract terms in the event of unforeseen hardship
- allowing consumers to seek relief from the Court to prevent oppressive conduct
- making other forms of redress availabe, including reparation from the Disputes Tribunal
- giving the Commerce Commission responsibility for promoting compliance with the Act.

The first major reforms to the CCCFA were made in 2015, following a review process that began in 2009 and was primarily concerned with unscrupulous 'fringe' lenders (an estimated 35% of whom were unregistered). The main changes were:

- introduction of responsible lending principles (and development of a responsible lending Code), including an obligation to be satisfied by reasonable inquiries that the loan is likely to be both suitable and affordable for the borrower (section 9C(3)(a) of the CCCFA)
- increased disclosure requirements
- new procedural requirements when the borrower makes an application on the grounds of unforeseen hardship
- making lenders liable for the costs of borrowing for any period during which they are unregistered (s99B) or have failed to make the initial disclosures required by section 17 or disclosure of agreed changes required by section 22 (s99(1A))
- incorporation of repossession laws into the CCCFA, with some improvements (based on recommendations from a Law Commission report).

The *Credit Contracts Legislation Amendment Act 2019* and amendment regulations made a series of reforms intended to address risk of harm to vulnerable consumers. This was in response to observations of continued irresponsible lending, unacceptable rates of non-compliance, uncertainty about how to fulfil certain obligations, and poor visibility of lending practices. With the exception of rules for high-cost credit, these reforms were applied to all lending in the interests of consistent standards and competitive neutrality.

The main changes and when they commenced were as follows:

- December 2019 – penalties created for breaching lender responsibility principles, statutory damages increased, new regulation-making powers, ability for court to reduce consequences of failure to make correct disclosures.
- May 2020 – additional restrictions (including a cost of credit cap) for high-cost credit.
- June 2020 – CCCFA obligations applied to mobile trader credit sales.
- June 2021 – introduction of 'fit and proper person' test for directors and senior managers.
- December 2021 – due diligence duty for directors and senior managers, requirement to maintain records showing how certain fees are calculated, requirement to maintain (and share on request) records of inquiries made into affordability, regulations prescribing minimum standards for assessing suitability and affordability of loans as well as advertising standards.

The nature of December 2021 changes

5. Lenders are required by section 9C(3)(a)(ii) of the CCCFA to be satisfied by reasonable inquiries, before lending or increasing lending, that the borrower will be able to make the repayments that might be required without suffering substantial hardship. Prior to 2021, lenders were supported to fulfil this obligation only by non-binding guidance in the Responsible Lending Code (the **Code**).

6. In its 2018 review of the CCCFA, MBIE had concluded based on case studies and insights from consumer groups, regulators, financial dispute resolution schemes and lenders that there were a range of compliance issues relating to affordability (among other obligations). The most serious cases involved some lenders performing 'only superficial testing of loan affordability and taking income and expense information provided to them by borrowers without proper questioning or verification, even where it was plainly incomplete or incorrect'.

7. Contributors to non-compliance were identified as including:

   a. a lack of clarity about what was required to comply with the lender responsibilities, which made it more likely that lenders would interpret the responsibilities in ways inconsistent with the intent, and reduce the ability for financial mentors and consumers to complain to the Commerce Commission and financial dispute resolution schemes

   b. inadequate documentation of lender processes and evidence relied on in affordability assessments, making it more difficult to identify non-compliant processes

   c. a lack of any penalties for breach of lender responsibilities, which failed to incentivise compliance.

8. To address this:

   a. MBIE worked with industry to adapt its understanding of 'best practice' into regulations which specify what minimum steps constitute 'reasonable inquiries' into affordability of the loan to the borrower (for the purposes of section 9C(3)(a)(ii))

   b. Parliament required lenders to keep records of the inquiries they have made into affordability, and share these with the Commerce Commission, the borrower or a dispute resolution scheme if requested

   c. Parliament created civil pecuniary penalties for breach of lender responsibility principles, increased statutory damages and created a personal liability for directors and senior managers.[1]

9. The original RIS did not analyse the likely impact of the affordability regulations independently of these other reforms. This means there is no way of deducing to what extent, if any, they were in fact necessary in their own right to address the problem.

Our investigation into the impacts of these changes

10. In early 2022 we investigated concerns that the affordability regulations were negatively impacting borrowers. We found that lending processes had become more restrictive and onerous than was expected, resulting in some unintended impacts:

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[1] The first two of these reforms came into force earlier than December 2021, but form a relevant part of the regulatory backdrop.

a. more borrowers across all lending types who should pass the affordability test having applications declined

b. borrowers being subject to unnecessary or disproportionate inquiries perceived by them as intrusive.

11. Overly restrictive and onerous lending processes were a consequence of:

a. the way a number of specific provisions in the regulations were designed and drafted

b. combined with interpretational difficulties

c. many lenders taking a naturally conservative approach to compliance given the CCCFA's strong liability regime (for example, underutilising the exception for 'obvious affordability').

12. The prescriptive nature of the CCCFA changes and their equal application to almost all consumer lending (with the exception of the high-cost credit provisions, which are subject to more burdensome requirements) also meant that lending was impacted outside of areas where there is a high risk of irresponsible lending and harm to consumers. Lenders could only in limited circumstances scale their inquiries to reflect the wide variation in risk presented by different products and borrower circumstances. The main exception for low-risk borrowers is the exception for 'obvious' affordability, which lenders were largely inhibited from using as intended by the degree of judgement involved and their liability.

13. This lack of flexibility in the regulations was also reducing lender discretion to deal with anomalies or respond to urgent need for credit that has arisen from a personal emergency, severe weather events, or other major unforeseen expenses.

Changes made to the affordability regulations in 2022 and 2023

14. The investigation identified several options to address these impacts. These options were analysed in a RIS finalised in June 2022, *Response to the investigation into 1 December 2021 credit law changes*.

15. Our preferred option was to explore ways to target the affordability regulations based on the risk profile of the lending. The previous Government did not originally agree to this approach, instead opting to make some relatively narrow adjustments to the regulations, specifically:

a. clarifying what inquiries are required to estimate expenses and more explicitly excluding discretionary expenditure

b. creating new exceptions for refinancing existing credit

c. expanding guidance on when the exception for 'obvious' affordability can be relied on.

16. The counterfactual set out in this RIS has moved on slightly from that set out in the previous RIS, to now include the above changes made to the regulations made by the Government.

17. We interviewed a range of lenders in the first half of 2023 to understand what difference these changes, and the passage of time, has made to their processes for complying with the affordability regulations (discussed further in the next section).

How is the status quo expected to develop without government intervention?

18. In the absence of regualtory intervention, we expect the affordability regulations to continue to unnecessarily constrain access to credit and impose disproportionate compliance costs.

19. We have continued to engage with lenders to understand to what extent the immediate impacts of the affordability regulations have been resolved and the nature of any ongoing impacts. We heard from lenders that their procedures for complying with the affordability regulations are now more settled and less problematic than at first.

20. However, we share their view that the adjustments made to the regulations since the investigation have failed to fully address the problems we identified. The regulations continue to impose a regulatory burden that is largely inflexible and, in certain cases, disproportionate to the likely risks to consumers. Absent regulatory change, we would expect:

    a. relatively low-risk loan applications to continue being affected by unnecessary compliance costs, longer than necessary processing times and negative consumer experiences

    b. some affordable loans at the margins continuing to be declined due to the largely inflexible nature of the regulations.

The Government is committed to reforming the CCCFA over two phases

21. The National Party's 100-point plan for Rebuilding the Economy committed to 'cut financial red tape that is stifling investment, including significantly reducing the scope of the CCCFA which has restricted access to credit.' The National and ACT Coalition Agreement included a commitment to 'Rewrite the Credit Contracts and Consumer Finance Act 2003 to protect vulnerable consumers without unnecessarily limiting access to credit.'

22. The Minister of Commerce and Consumer Affairs' view is that the most pressing problem with the CCCFA is the regulations prescribing how lenders should assess affordability. The Minister has indicated to officials that he would like to remove the prescriptive affordability requirements in regulations for lower-risk lending as a matter of priority.

23. This would be the first phase of a two-phased process for reforming consumer credit legislation. Phase two is expected to include:

    a. addressing the related issue of liability for directors and senior managers (which the investigation acknowledged appears to contribute to overly conservative application of the affordability regulations)

    b. a review of the CCCFA's high-cost credit provisions (which is required by section 45L of the CCCFA)

    c. other discrete issues with the CCCFA.

24. These would form part of a package of wider reforms to financial services regulation.

25. In publicly announcing this approach to reforming consumer credit legislation, the Minister stated an intention to transfer responsibility for the CCCFA from the Commerce Commission to the Financial Markets Authority.

Competition in personal banking services is currently the subject of a Commerce Commission market study

26. The Commerce Commission (as the competition regulator) is undertaking a study into competition in the provision of personal banking services, with a draft report due for release on 21 March 2024 expected to identify barriers to competition. Sixteen registered banks operating in New Zealand participate in markets for consumer credit through the provision of products such as home loans, credit cards, personal loans and vehicle finance. The market

study may also include findings about the role of non-bank deposit-takers and finance companies given they affect competition for the supply of personal banking services.

What is the policy problem or opportunity?

27. The problem is that requirements in the regulations for assessing affordability are largely inflexible and, in certain cases, more onerous than justified by the risks to borrowers. This unnecessarily increases costs for lenders and borrowers[2], and is thought to result in some consumers being denied credit they can in fact afford.

28. Our assessment is that this problem is somewhat less pronounced than it was in early 2022, but still persists. This is based on an analysis of lending data, information provided more recently by lenders and new consumer credit survey data.

Evidence of the problem: decrease in lending activity under the regulations

29. The investigation report[3] used lending data and case studies to infer that reforms effective in December 2021, including the affordability regulations, contributed to a drop in new lending for home loans and other consumer loans.

30. There was a reduction in both demand for credit and the conversion rate of applications for credit. Neither of these trends can be directly linked to the CCCFA changes in the presence of other factors. Other factors include:

    a. for home lending – LVR changes, increased interest rates, inflation and a general property market slowdown

    b. for other consumer lending – inflation, cost of living increases, and the ongoing impacts of COVID-19 on spending, saving and borrowing behaviour.

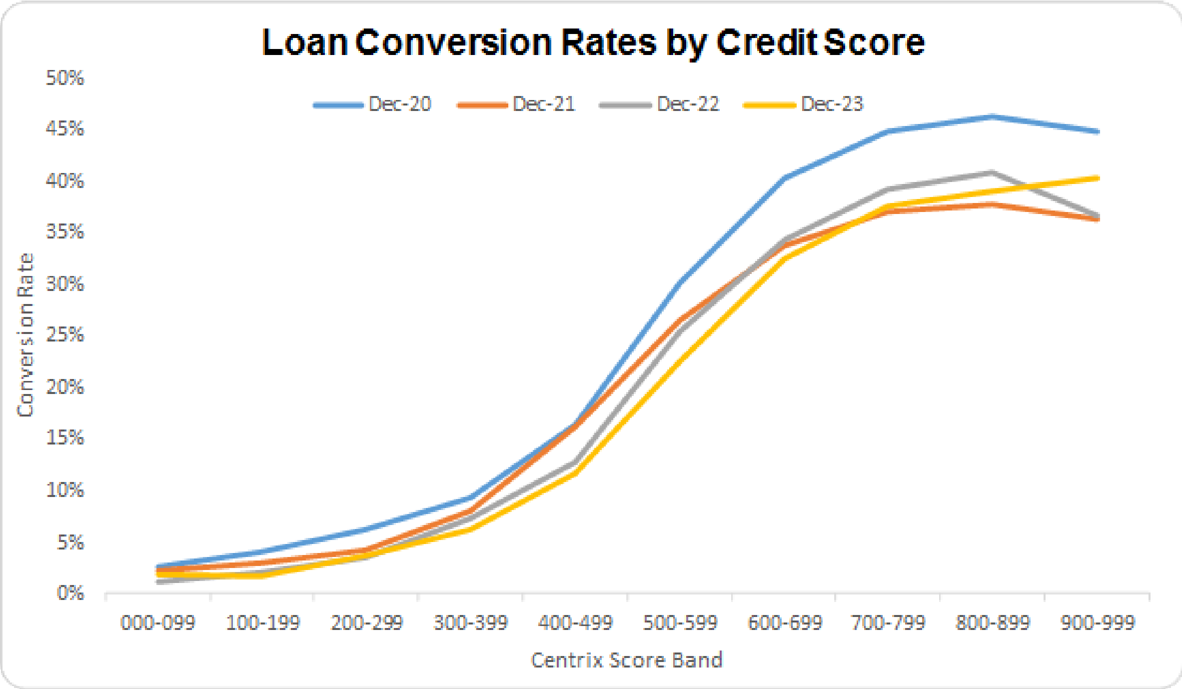
31. Consumer lending volumes have largely recovered in the last two years.[4] However, an increase in demand for credit appears to account for much of this. Conversion rates remain lower than in 2020 (by about 11%), and this continues to affect borrowers with higher credit scores, as shown in the updated graph below.

[2] Although we would generally expect compliance costs to be passed onto consumers, this also refers to the time and effort costs borrowers incur directly.

[3] The 2022 investigation report is accessible here: Early implementation and impacts of 1 December 2021 credit law changes (mbie.govt.nz)

[4] RBNZ data for December 2023 shows consumer home loan volumes are back to almost 80% of mid 2021 levels and personal loans back to around 70%. Data available here: New lending by purpose (C70) - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

Figure one: loan conversation rates[5] by credit score



Evidence of the problem: borrowers and lenders reported that lending processes have become more intrusive and time-consuming

32. In early 2022, lenders said borrowers were complaining that the new, more in-depth inquiries being conducted as part of the affordability assessment are time consuming and intrusive in nature. All lenders indicated their processing time for applications on all products had increased by 50% or more following implementation of process changes in accordance with the CCCFA changes. This was driven by the need to capture a wider range of expenses in accordance with the regulations, and more in-depth inquiries being made into those expenses. This was also reflected in some complaints data the investigation report noted.

33. There is also evidence that for some types of credit contracts, like temporary overdrafts, borrowers have been dissuaded by the more onerous process itself, which is not reflected in declines in conversion rates (since an enquiry would not have been made to the credit reporting agency at all).

Why conclude that this reveals unintended impacts of the affordability regulations?

34. We cannot know to what extent the lending trends discussed above are a direct result of the affordability regulations. Nor can we know to what extent any role the affordability regulations played in reducing access to credit or prolonging inquiries was intended by those regulations (i.e. necessary to protect borrowers from geniune affordability risks).

35. The investigation report inferred that some portion of the above impacts were unintended consequences of the CCCFA changes, rather than being justified by underlying affordability concerns. This inference was made on the basis of:

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[5] These conversion rates are derived from comparing the number of credit enquiries with the number of new loans entering lenders' books.

a. case studies provided by lenders showing how processes implemented in response to the CCCFA changes have led to credit being declined – either through greatly increased expense estimates, large surplus requirements or a lack of discretion to consider wider factors

b. the fact that borrowers with high credit scores were disproportionately affected by lower conversion rates[6]

c. information we gathered about how the regulations were interpreted and applied.

36. These inferences are now further supported by consumer credit survey data procured by MBIE. In particular, this data suggests that, compared with borrowing in 2019, consumers in 2023 who were declined a credit card, overdraft or home loan were less likely to believe this was in their best interests.

Who does this affect?

37. All consumers who enter into consumer credit contracts are potentially affected by one or both of these unintended impacts. 39% of people aged 18 and over entered into a credit contract in the two years.[7] These consumers were more likely than the general population to be aged between 27 and 46, employed full-time, Māori and educated.

38. Given the affordability regulations were part of a range of reforms originally intended to protect 'vulnerable' borrowers in particular, it is less vulnerable borrowers who are unnecessarily affected by disproportionate inquiries and processing times. The Responsible Lending Code defines vulnerable consumers in terms of being:

a. unlikely to understand the nature of the transaction or the information provided (for instance because they do not have a good understanding of English or because they do not have basic knowledge about financial matters), or

b. under significant pressure to obtain credit or give a guarantee (for instance, where the credit is needed urgently or for necessities, or where the borrower or guarantor is under undue influence from another party to obtain credit or give a guarantee).

39. The number of borrowers with these characteristics is difficult to estimate, because (as the Code makes clear) risk and vulnerability is best judged in the circumstances. However, over time, we have generally understood this as comprising a minority of the borrower population. For example, credit scores are one imperfect way to estimate risk of the borrower struggling to make repayments (which is related to the concept of vulnerability). According to data MBIE has obtained from Centrix, only around 10% of borrowers subject to credit enquiries since January 2023 had credit scores below 400, putting them in Centrix's 'high-risk' band.

40. There are some estimates of the proportion of borrowers actually affected by these issues, although care is required in interpreting these figures. In the case of declines, individual banks estimated in early 2022 that 6–7% of their home loan borrowers who would have previously

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[6] Credit scores are an imperfect proxy for the likelihood of the borrower facing affordability issues with new loan applications. On that basis, they provide only an indication of the population in which we expected to observe a reduction in approved loans (namely, at the lower end of the spectrum).

[7] Page 32 of the NZ 2022 Consumer Survey, accessible here: [New Zealand Consumer Survey 2022: Survey findings (mbie.govt.nz)]

qualified were instead being turned down. However, these estimates do not reveal how many of these borrowers were *unnecessarily* declined home loans.

Underlying causes of the problem

Lack of targeting

41. The regulations apply to almost all consumer lending with limited exceptions, rather than just lending where there is a significant risk of harm. While the regulations were intended to apply to all consumer lending, they were not expected to significantly impact many low-risk situations, on the basis that lenders already implemented similar processes to those required. For example, banks providing mortgage lending to first home buyers were generally thought to have robust processes for assessing affordability, and much of the design of the regulations was based on these processes.

42. This issue is resulting in unnecessary or disproportionate inquiries to lower-risk borrowers and has some implications for borrowers being unnecessarily declined.

Design and drafting of specific provisions in the regulations

43. Regulation 4AF(2) sets a formula for most affordability assessments. 4AF(2)(b) requires likely income to be greater than likely expenses, including appropriate surpluses or buffers/adjustments to account for uncertainty, which takes away the ability for lenders to approve lending based on other factors that might suggest affordability.

Conservative interpretations driven by liability regime

44. The interpretation and implementation of the regulations has sometimes been more onerous and restrictive than the original policy intent. The regulations typically provide multiple pathways for lenders to comply. Although prescriptive overall, they include many provisions that were intended to involve judgements about what is 'reasonable' in the circumstances. For example:

    a. Some lenders appeared in early 2022 to be estimating living expenses by asking the borrower to declare them, reconciling them from bank transactions records and comparing them against a benchmark. The policy intention was that, where a borrower declared living expenses, they could either be verified against bank transaction records or compared against a benchmark (where both of these were options).

    b. Some lenders had set surplus income requirements in a way that did not appear to be 'discounted' for other adjustments and buffers used in income and expense estimates.

    c. Lenders have generally found it difficult to make systematic use of the exception for 'obvious' affordability.

45. A key driver of conservative interpretations is the relatively strong liability and penalties regime in the CCCFA, in particularly the creation of personal liability for directors and senior managers and inability to insure against that liability. This means that lenders have tended to take the interpretation that yields a more conservative and easily defensible result.

46. A more conservative approach typically results in lower income estimates, higher expense estimates and more extensive surpluses, buffers and adjustments. This results in a greater likelihood that lending will be declined. It also results in more detailed inquiries than may be strictly necessary, and a reluctance to make use of exceptions to a full affordability assessment.

What objectives are sought in relation to the policy problem?

47. The primary objective is to straightforwardly reduce the compliance burden created by the affordability regulations. This reflects the Minister's expectations and the constraints created by this being the first of two phases in reforming consumer credit legislation (discussed at paragraph 21).

48. Other objectives are:

    a. regulation is proportionate to the risk of harm to consumers

    b. regulatory obligations are clear for lenders and the regulator

    c. consumers have access to credit without undue risk of harm

    d. regulatory obligations provide a level playing field for lenders to compete in consumer credit markets.

49. These objectives reflect the competing interests of consumers in having access to credit from lenders operating efficiently and being protected from harm created by unaffordable credit (which cannot be avoided without higher compliance costs).

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

50. To assess all the options against the status quo, we have used five criteria that reflect the policy objectives and need for options to be straightforward to implement:

    a. minimising costs to lenders and consumers through unnecessary inquiries and processing times

    b. minimising cases (and attendant harm to consumers) where lenders decline credit that is likely to be affordable (false negatives)

    c. minimising harm from cases (and attendant harm to consumers) where lenders approve unaffordable credit (false positives)

    d. regulatory obligations provide a level playing field for lenders to compete in consumer credit markets

    e. certainty and ease of implementation for lenders in advance of further reforms (phase 2).

Weighting

51. We have chosen to weight these criteria equally. While criteria **a** and **b** reflect the problem and main motivation for phase one of reforms, criterion **c** is supported by the primary purpose of the CCCFA to protect the interests of consumers. Given the direct relationship between competition and the interests of consumers recognised by the CCCFA, we place equal weight on criterion **d**.

52. Criterion **e** has been used to shortlist phase one options, but also aids comparison of their effectiveness. The success of phase one in addressing the problem identified will ultimately depend on the willingness of lenders to adapt their established processes for assessing affordability so that their inquiries are more proportionate to risk. This willingness is likely to reflect the costs, complexity and certainty that each option creates while the regulatory environment is still subject to change through phase two of the reform process.

Assumptions made in developing and applying the criteria

53. We have built into the wording of criterion **b** the assumption that consumers are sometimes harmed by being declined credit they can afford. Access to affordable credit can in some cases affect prospects of employment, medical care and the long-term benefits associated with home ownership. Access to credit is relevant to the secondary CCCFA's purposes of "promoting the confident and informed participation in markets for credit by consumers" and "promoting and facilitating fair, efficient, and transparent markets for credit" (section 3 of the CCCFA).

54. We have built into the wording of criterion **c** the assumption that being approved unaffordable credit generally causes harm to consumers. We use the concept of 'affordability' in this RIS as shorthand for what section 9C(3)(a)(ii) describes as the question of whether the borrower can be expected to make payments under the contract without "suffering substantial hardship". Any borrower is harmed who has accepted credit that puts them in this position. 58% of borrowers who had difficulty repaying a loan rated the impact on their everyday life as 'moderate' or 'severe' in a consumer credit survey we procured this year. Problematic borrowing and lending decisions can affect long-term quality of life for the borrower, including

their mental health, and the borrower's family (e.g. through relationship breakdowns, loss of employment[8] and unstable housing).

55. How options perform against criteria **a**, **b**, **c** and **e** partly depend on how effectively lenders are supported by guidance in the Code. Effective guidance would contribute to the likelihood of affordability assessments that are proportionate to risk, while reducing the likelihood of lenders over-relaxing their affordability assessments.

56. The need for this guidance was recognised by the full range of stakeholders we consulted. For the purpose of our analysis, we have assumed this guidance would be reasonably effective in supporting lenders to adapt their processes for assessing affordability consistent with the lender responsibility obligation in the CCCFA. However, given the Code is not legally binding, it would ultimately be open to lenders to disregard the Code in developing processes they believe are reasonable for the purposes of the CCCFA.

What scope will options be considered within?

57. MBIE's preferred option in the earlier RIS was to better target the affordability regulations to specific kinds of lending, lenders or certain consumers where there is a higher underlying risk of substantial hardship. That RIS discussed a few possible ways application of the regulations could be limited on the basis of lending types, lenders or borrower characteristics, rather than fully exploring any particular one of them.

58. This RIS does not consider the full range of ways of limiting the application of the regulations. The scope of options is now limited by the responsible Minister's request for a solution via amendments to the affordability regulations that can be implemented in a straightforward manner and quickly for the benefit of lower-risk lending.

59. He has publicly announced his intention to pursue reforms to primary legislation on a longer timeframe. This second phase of reforms creates some uncertainty for lenders relevant to the options considered in this RIS because:

    a. Phase two reforms would be an opportunity to revisit the issue of affordability requirements, including by reducing the impact of liability settings.

    b. The Minister stated his intention to transfer responsibility for consumer credit from the Commerce Commission to the Financial Markets Authority. The Financial Markets Authority has a more proactive, less enforcement-focussed approach than the Commerce Commission and a greater interest in supporting regulated parties to meet obligations flexibly. This difference in approach may well influence long-term lender expectations.

60. To account for the risk that lenders are inhibited by this uncertainty in making changes necessary to address the problem, we have confined our analysis of options to those that straightforwardly disapply the affordability requirements to all or certain lending. We have done this with minimal tolerance for complexity, introduction of new costs or potential for implementation issues.

61. Furthermore, the liability settings in the CCCFA are likely to undermine any options that increase the degree of judgment required of lenders to navigate the regulations (e.g. by

[8] Some security-sensitive jobs such as corrections officers and police officers cannot be held by people undergoing No Asset Procedures.

introducing a complex or unclear distinction). This can be observed in the under-utilisation of the exception for 'obvious' affordability already provided by regulation 4AG.

62. This general approach rules out several options we judge to be more complex or uncertain in their application. Notably, our shortlist excluded several borrower charactestics that could be used to disapply the affordability regulations. These options were either too complex for this reform process (for example, targeting the regulations based on a definition of borrowers who are likely to be more vulnerable to the risk of taking on unaffordable debt) or too uncertain in their application and consequences (for example, using credit scores, which has some immediate implementation risks and unknown social impacts).

63. We have also disregarded options that attempt to reduce prescription in the affordability regulations themselves, whether instead of or in addition to switching them off for certain lending.

64. We are conscious that these constraints limit us to relatively crude options that may provide less effective solutions to the problem. They also limit our ability to build into options ways of mitigating risks associated with not specifying what steps constitute 'reasonable inquiries' for the purpose of the CCCFA's requirement to assess affordability. This likely increases the importance of providing good guidance in the Code (where the affordability regulations would not apply).

65. Finally, we note there are no non-regulatory options for addressing this problem, given the problem is attributed to the affordability regulations. The Code is secondary legislation and must be consistent with requirements in the affordability regulations.

What options are being considered?

66. We have shortlisted four regulatory options as appropriate for phase one of the Minister's reforms to consumer credit legislation. They disapply the affordability regulations either partially, based on characteristics of the lender or the credit product that are easy to identify, or completely:

    a. Option One: Status quo

    b. Option Two: Disapply the affordability regulations to registered banks and non-bank deposit takers

    c. Option Three: Disapply the affordability regulations to home loans

    d. Option Four: Disapply the affordability regulations to lending below a certain annual interest rate

    e. Option Five: Revoke the affordability regulations.

67. Where affordability regulations no longer apply, lenders would still be required by the CCCFA to be satisfied by 'reasonable inquiries' that the borrower will be able to make repayments without suffering substantial hardship and keep records of these inquiries. Rather than follow the minimum steps prescribed by the regulations, they would need to exercise greater judgment about what inquiries are appropriate in each case. This would give all lenders more discretion to adjust their level of inquiries based on the risk profile of their lending. We would develop guidance in the Code to support lenders to exercise good judgments about this. This was the position for all lending between June 2015 and 1 December 2021.

68. Given the constraint on complexity of options, we have treated all of these options as mutually exclusive. In theory, you could get a different result by combining certain options (such as

options two and four by setting the interest rate low enough to exclude some types of credit offered by banks and non-bank deposit takers). However, this would incur the implementation costs and risk of unintended consequences of both options.

69. We have chosen home loans as the credit product for Option Three on the basis that they are an easily defined and a relatively low-risk product in terms of the general profile of borrowers, relatively low levels of arrears and debt enforcement compared with other products.

70. We were able to consult a targeted range of stakeholders (i.e. representatives of various lenders, consumer groups and the Commerce Commission) on options Two, Three and Four (using an annual interest rate of 30%) in January this year. These were options we were actively advising the Minister on at the time. Consultation was limited to one Roundtable meeting (attended by the Minister) and three days for participants to provide any further written comments on the options.

Option One – Status Quo

71. All consumer credit lenders would still need to comply with prescriptive affordability requirements.

72. Affordability processes developed by lenders to comply with the current regulations are well established, and we would not expect them to change in any material way. Liability settings likely increase this inertia.

73. This option offers the greatest level of consumer protection, by deterring lenders from making insufficient inquiries into affordability and giving the Commerce Commission relatively clear grounds for enforcement in the event of non-compliance (compared with having to prove non-compliance with the principal obligation in the CCCFA). But the costs and regulatory burden are not proportionate to the risk of harm to consumers in certain cases. This option imposes excessive ongoing costs on lenders and consumers through unnecessary inquiries and processing times, and has the greatest potential to deny consumers affordable credit.

74. This option provides a level playing field for all lenders and presents no implementation challenges for lenders.

Option Two – Disapply the affordability regulations to registered banks and non-bank deposit takers

Description of option

75. Disapplying the affordability regulations to registered banks and non-bank deposit takers (together 'deposit takers') would give them discretion to make less extensive inquiries than those prescribed by the regulations, while leaving other aspects of the CCCFA regime intact. Deposit takers are subject to prudential regulation by the Reserve Bank of New Zealand and some limited conduct regulation by the Financial Markets Authority (as well as new requirements under the Financial Markets (Conduct of Institutions) Amendment Act 2022, due to commence in March 2025). Australian-owned banks are also subject to some additional prudential requirements that do not apply in New Zealand.

76. Deposit takers are businesses that both lend and borrow from the public through the issue of debt securities or savings account or term deposit products. There appear to be 16 unique banks registered and operating in New Zealand and 16 non-bank deposit takers (e.g. credit unions) who would benefit from this option. They offer a range of credit products regulated by

the CCCFA, including home loans, credit cards, overdraft facilities, other revolving credit facilities, vehicle finance and personal loans.

Benefits

77. This option would benefit a class of lenders who account for a significant proportion of consumer lending by enabling them to develop affordability assessment processes that avoid unnecessary inquiries and processing times, and may reduce the incidence of false negatives (credit being declined that is likely to be affordable).

78. The problem identified in this RIS reflects our view that less extensive inquiries than those prescribed by the regulations are sufficient in certain cases for lenders to be satisfied the lending will be affordable (as required by the CCCFA). Accordingly, this option would support deposit takers to reduce the costs of processing loans in these cases, which would also improve the experience of their customers. We would ordinarily[9] expect these savings to be passed on to those consumers whose credit is approved. Consumers may also benefit from a more favourable approval rate for affordable credit (i.e. greater access to credit).

79. We assess the probability of these benefits as high, despite some uncertainty. What we have heard from representatives of deposit takers leads us to expect they would, in due course, make changes to their affordability processes that achieve this under this option. Lenders incur would incur costs from developing these changes (which seem to be loosely proportionate to the size of the company). But these costs are likely to be outweighed over time by pressure to reduce the burden on consumers whose custom they compete for (given how highly consumers tend to value timely loan processing).

Costs/risks

Factors relevant to assessing risk of unaffordable lending in the absence of affordability regulations

80. A risk with all options is the possibility that lenders (in this case deposit takers) relax their inquiries into affordability to a greater extent than is intended to deliver the benefits discussed above. They could relax their processes to such an extent that they become less reliable at declining cases where the loan is unlikely to be affordable. Failure to withhold unaffordable credit would disproportionately affect borrowers who are less well equipped to judge affordability of the credit themselves (due, for example, to low levels of financial literacy, a poor understanding of English, financial stress, or pressure from family members to obtain credit). Māori, Pacific peoples and immigrants are likely to be over-represented in these groups.

81. We find the risk of unaffordable lending difficult to quantify (across all options), as the affordability practices lenders adopt in the absence of the regulations would be subject to two opposing pressures:

    a. **Competitive pressure** to process loans more quickly and with minimal burden on consumers would incentivise lenders to make the minimum inquiries into affordability that are necessary to protect their commercial interest in the recoverability of the debt

[9] All costs of loan processing can be expected to be passed onto consumers through interest rates of fees. If there is workable competition between lenders affected by the change, then they can likewise be expected to pass any savings on to consumers as their processing costs are reduced. We note the Commission is investigating the extent of competition for personal banking services.

(i.e. minimising credit risk) and legally defensible.[10] In terms of credit risk, deposit takers, particularly banks, have relatively strong commercial incentives to ensure credit is appropriately provided and default rates remain low. They tend to be sensitive in their choice of customers to credit risk in order to avoid the costs of enforcing debt (e.g. repossession and sale of secured property). However, assessing credit risk is not the same as assessing the consumer's ability to 'make payments under the agreement without suffering substantial hardship.'[11] Commercial interests therefore do not directly protect against false positives.

b. On the other hand, **liability settings** in the CCCFA may continue to contribute to overly conservative approaches to compliance with legal obligations. Lenders must keep records of their inquiries into affordability and may still be required to demonstrate these inquiries were reasonable in each case. The transparency of their inquiries and their liability for breaching the obligation to make reasonable inquiries, together, are likely to influence how lenders navigate uncertainty about what constitutes reasonable inquiries into affordability. The extent of this influence depends on how expectations relating to affordability assessments are set by guidance in the Code, as well as the regulator's approach to monitoring and enforcing these expectations.

82. It is difficult to determine what impact liability settings would continue to have on the care lenders take in assessing affordability once they are no longer bound by the affordability regulations. We would not expect overly conservative approaches beyond what they judge to be legally defensible. Disapplying regulations the Commission and consumer advocates rely on to demonstrate certain inquiries are insufficient, and seek redress, would ultimately tend to improve the confidence of lenders they can defend inquiries as 'reasonable' even when they produce false positives.

83. Potential for over-relaxed inquiries is supported by the limited feedback we received from lender representatives on the options in this RIS, which suggested they expect to be able to adopt less stringent inquiries for a large portion of their lending (if not right across their books).

84. Finally, there is an argument that deposit takers are more likely to conduct appropriate affordability assessments than other lenders because they are also subject to prudential regulation by the Reserve Bank of New Zealand and some service-specific conduct regulation by the Financial Markets Authority.[12] The four large Australian-owned banks are also regulated by the Australian Prudential Regulation Authority, who impose some specific serviceability requirements that do not apply in New Zealand.

85. These other forms of regulation are not substitutes for protections provided by the CCCFA, but do constrain deposit takers in ways that can help to reduce the risk of unaffordable lending, particularly for home loans. For example, restrictions imposed by the Reserve Bank (such as

[10] Deposit takers who achieve this are likely to be rewarded by borrowers who value shorter processing times, which places pressure on other deposit takers to respond. This is the competitive process we see as a catalyst for relaxing inquiries.

[11] Unaffordable credit can have a high likelihood of recovery if, for example, the lender takes a security interest and has effective enforcement. Borrowers can also have an increased likelihood of repaying debt even at great personal sacrifice ('substantial hardship') for social/cultural reasons or to maintain a good credit rating.

[12] The new conduct licensing regime introduced by the Financial Markets (Conduct of Institutions) Amendment Act 2022 contributes to this argument. It would mean that deposit takers are subject to general conduct regulation by the FMA over the products and services they provide to consumers, including consumer credit.

capital adequacy requirements and, for home loans, restrictions on loan-to-value ratios) help to ensure deposit takers manage risk across their books of being unable to recover debt.

Impact on competition

86. The Commerce Commission, as New Zealand's competition regulator, has significant concerns about the harm this option may cause to competition in markets for consumer credit.

87. Any option that differentiates requirements for different kinds of lenders has the potential to harm competition by providing some with a material competitive advantage over others. Deposit takers offer a range of credit products in competition with other lenders who would not benefit from this option. For instance, banks actively compete for the provision of personal loans with non-bank lenders, currently providing more of these in dollar terms.[13]

88. By appearing to give deposit takers a competitive advantage through reduced regulatory burden (and setting a precedent of differentiating regulatory requirements by class of lender), this option could have an immediate chilling effect on other lenders entering the market.

89. To the extent the change enables deposit takers, over time, to reduce their compliance costs and shorten their loan processing times, it can be expected to increase their market share and lessen competition. Disadvantaged lenders exiting the market, or reducing the extent to which they compete for the same borrowers as deposit takers, would adversely affect consumers (e.g. by reducing choice, the diversity of products available and price competition).

90. We note for completeness the suggestion that this option would correct an existing competitive disadvantage deposit-takers face in consumer credit markets by being subject to prudential and limited conduct regulation. We do not agree that their legal status as deposit-takers creates a competitive disadvantage needing to be corrected.

Stakeholder views

91. Deposit takers support this option on the basis they are already subject to considerable regulation, and have comparatively low default rates. Consumer advocacy groups argued that consumers still experience hardship resulting from unaffordable loans granted by these lenders.

92. Second-tier lenders argued this option is anti-competitive. In contrast, banks and a legal advisor considered this option would correct existing competitive disadvantage banks face due to additional regulation. The Commerce Commission assesses this option as detrimental to competition.

Option Three: Disapply the affordability regulations to home loans

Description of option

93. This option would disapply the affordability regulations to home loans. We would limit the definition of a relevant home loan to avoid incentivising multiple lenders to secure their credit to the borrower's property as a way to avoid having to comply with the affordability regulations.

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[13] Reserve Bank of NZ: "Registered banks and non-bank lending institutions: sector lending (C5)", available at: [Registered banks and non-bank lending institutions: Sector lending (C5) - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)]

Benefits

94. This option would have similar benefits to Option Two, but probably on a reduced scale. While home loans account for a significant proportion of consumer lending in dollar terms, the benefits are enjoyed on a per-loan application basis. Home loans are only a subset of products offered by deposit takers, though they are also offered by a small number of lenders who are not deposit takers (of whom we have identified 11).

95. We have also heard from banks that they would continue using their current approach to assessing affordability in cases where consumers apply for a home loan at the same time as an unsecured credit product (e.g. credit card). However, they have not been able to provide data indicating what proportion of home loan applications this would affect.

Costs/risks

Risk of unaffordable lending

96. The same factors relevant to risk of unaffordable lending discussed in relation to Option two apply here. We believe this risk is slightly muted under this option, given both:

    a. the reduced scale of lending that is not subject to the affordability regulations (compared with Option Two)

    b. our assessment of home lending as a fairly safe form of credit relative to other products.

97. We have historically seen fewer concerns with affordability assessments for home loans as compared with other credit products. The market for home loans is characterised by relatively:

    a. informed and financially stable borrowers (with low arrears rates compared with credit cards and other lending types)[14]

    b. low interest rates

    c. high sensitivity to credit risk

    d. low levels of debt enforcement

    e. lenders who are mostly subject to prudential and service-specific conduct regulation that includes requirements specific to home lending (as discussed in relation to Option Two).

98. We acknowledge that the principal amounts involved and size of repayments are much higher under home loans than other types of credit. Moreover, the credit is secured to property, which the borrower often occupies. The consequences for borrowers are therefore greater in the event that these loans are provided despite never being affordable, and lenders are not necessarily as motivated as borrowers to avoid these consequences given their security interest.

99. However, the relatively high stakes if home loans prove unaffordable are offset to a large extent by reduced probability and by the specific benefits derived from home ownership (such as long-term financial security, capital gains, stability of occupation, stronger ties to the community).

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[14] 1.47% of home loans were reported as in arrears according to February 2024 Centrix data (which is the highest reported level since March 2020), compared with 6% for vehicle loans and 4.9% for credit cards.

Impact on competition

100. This approach would provide a more competitively-neutral basis for disapplying the affordability regulations than Option Two. Home loans are a distinct credit product that a range of lenders offer in competition with one another.

101. We have considered less direct risks to competition with this option and view them as immaterial. Consumers who obtain home loans typically obtain access to revolving credit facilities they can use for new expenses (e.g. improvements to the home or spending unrelated to home ownership). These forms of credit theoretically compete with other unsecured credit products, such as credit cards and personal loans, and would be advantaged by this option.

102. In practice, however, home loan facilities tend to outcompete these other forms of credit on price by offering lower interest rates and fees (with the exception of some credit card products that offer a period of low or no interest). Some home owners may nonetheless prefer unsecured credit for other reasons, such as privacy, to compartmentalise spending or to repay the loan faster. Disapplying the affordability regulations to home loans is likely to have some impact on these consumer preferences. But we do not see this as a significant or harmful impact given it would tend to reinforce borrower preferences for better priced credit.

Uncertainty and implementation costs for lenders

103. How we define the home loans affected by this option may involve some complexity or ambiguity for lenders.

104. This option has higher implementation challenges for lenders compared with Option Two by applying to a subset of their lending. This means that, to make use of this option, they would need to build into their systems some way of differentiating their approach to assessing affordability depending on the type of credit applied for. We are told by banks that this is likely to increase their costs and lead to confusion for customers who observe the difference in how affordability is assessed across products.

105. There is a risk that costs associated with implementing different processes under any option may mean that banks choose not to relax processes for home-loans. This risk is more pronounced given lenders may be anticipating further changes to loan processes as a result of the second phase of consumer credit reforms that have been signalled (including a transfer of responsibility to the FMA).

Stakeholder views

106. Second-tier lenders consider this option to be anti-competitive, but the Commerce Commission considers it less problematic in terms of competition (compared with Option Two). ANZ and BNZ are also not in favour of this option, arguing it would require two different affordability processes depending on product, increasing implementation costs and confusion for customers.

107. Consumer advocacy groups favour this option over other Options Two and Four, but generally prefer the status quo.

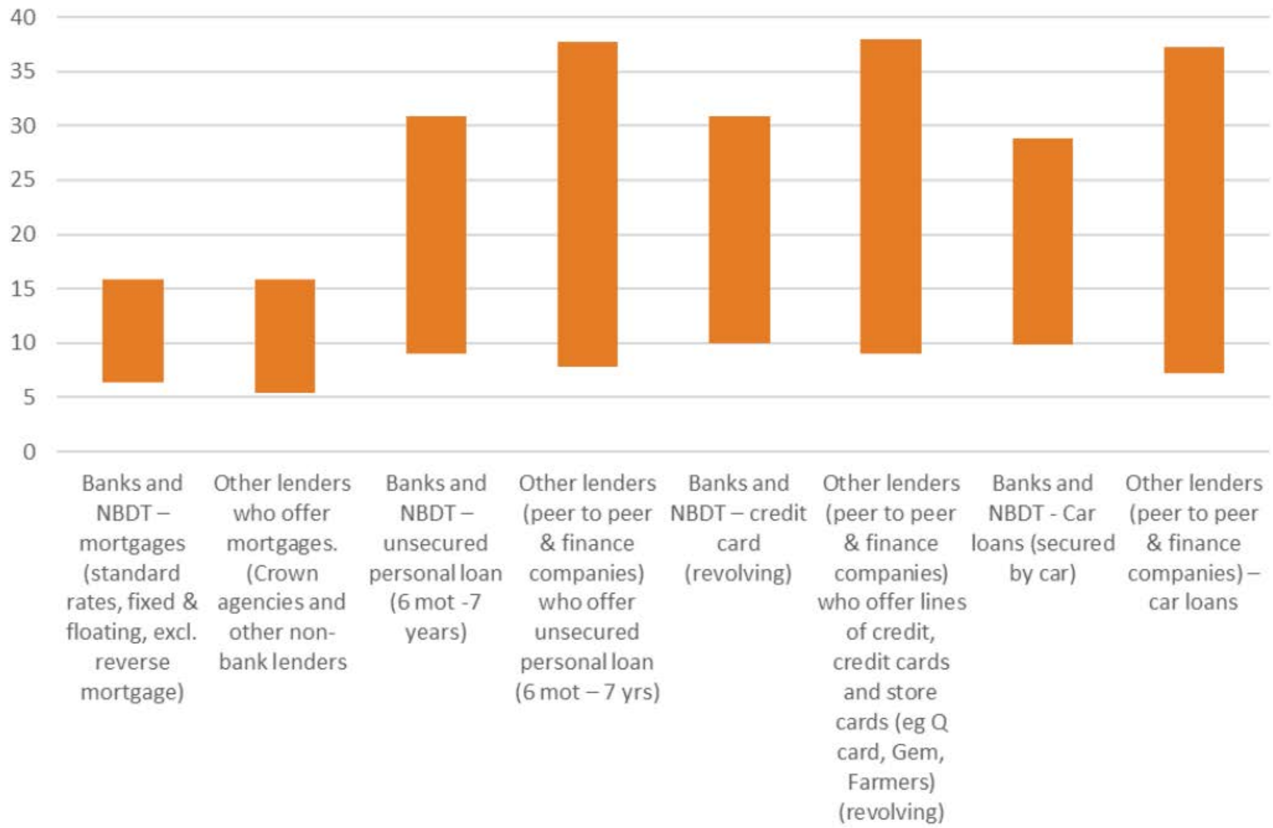
Options Four A and Four B: Disapply the affordability regulations to lending with an annual interest rate below a certain threshold

Description of option

108. This option would be to disapply the affordability regulations on the basis of annual interest rates. The chosen annual interest rate for could make a significant difference to its impact.

109. We have used annual interest rates of 15% and 30% as sub-options (Four A and Four B) for the purposes of further analysis, in order to show the contrast of impacts between a high and low threshold. But we note that other interest rates could be used. The below diagram shows the range of interest rates currently offered for different types of loan.

Figure two: types of credit product offered by annual interest rate



110. There is some logic in linking risk to borrowers with interest rates. The idea is essentially that interest rates approximate returns for the lender (given the CCCFA requires fees to be justified on the basis of actual costs), returns often influence lenders' tolerance for credit risk, and lower tolerance for credit risk incentivises responsible lending.

111. This option would not include any products regulated by the CCCFA that are provided with no interest charges, notably mobile trader contracts (which build profit into the sale price of goods, paid by instalments).[15] These products generate profits from other means, making interest rates a poor indicator of risk.

Benefits

112. The benefits of this option would be the same as for Option Two, but on a scale that depends on the chosen interest rate. A 15% threshold would capture much of the same lending by deposit takers in Option Two, but also reward other lenders who compete with them by offering similar kinds of credit. A 30% threshold would extend the benefits to an estimated 95% of all lenders in the market (at current interest rates) and their customers.

113. However, it is important to note that avoidance of false negatives (consumers being declined affordable credit) does not necessarily scale as these options disapply the affordability regulations to a greater range of lending (i.e. credit at higher interest rates). Our evidence of

[15] There are currently 10 mobile traders certified by the Commerce Commission.

false negatives associated with the status quo is limited to case studies provided by banks during the 2022 investigation. This means we have no basis for expecting fewer false negatives where the regulations are disapplied to lending by non-banks.

114. This option has some potential for price benefits to consumers by incentivising lenders to reduce interest rates that are marginally above the threshold.

Costs/risks

115. By applying to a wider range of lenders (even with a 15% threshold), this option tolerates a greater risk of unaffordable lending than the other options above. This is because it would apply to a greater number and diversity of lenders, each with their own appraoches to assessing affordability.

116. With a 30% threshold, benefiting the full range of lenders, the risk of inadequate affordability assessments and attendant false positives increases relative to other options. Unaffordable lending could also cause greater harm to consumers the higher the interest rates, because debt accumulates more quickly in the event of default. Christians Against Poverty shared meta-data with us on cases over the last three years in which they have successfully disputed loans on the grounds of unaffordability for the borrowers they represent. Less than 10% of these contracts had annual interest rates below 15%. Whereas, 90% of these successful disputes concerned contracts with an interest rate below 30%.

117. This option involves some risk of lenders lowering their interest rates to avoid having to comply with the affordability regulations, and then compensating themselves by increasing fees. The CCCFA prohibits fees from being used to generate profit. But the Commerce Commission notes the possibility that some lenders may risk non-compliance with this prohibition to avoid being subject to the affordability regulations.

118. This option is likely to impact competition by disadvantaging those lenders who continue to offer credit above the chosen threshold. As with Option Three, the impact on competition may be positive where it reinforces consumers' preference for better priced credit. However, the consequences of segmenting the market on the basis of an interest rate are difficult to predict, and we see some potential for harm to consumers. Interest rates often reflect the degree of credit risk lenders are prepared to accept from the borrower. This means that cheaper credit from more mainstream lenders is unavailable to certain borrowers. A threshold that places pressure on this end of the market (that squeezes lenders who service this demographic) may increase financial exclusion experienced by these borrowers.

119. Finally, the same uncertainty and implementation challenges for lenders noted in relation to Option Three are associated with this option. In particular, there would be additional complexity for lenders in developing ways to differentiate their treatment of credit applications based on the relevant interest rate.

Stakeholder views

120. We consulted key stakeholders on this option with a 30% threshold:

    a. Second-tier finance providers favour this option over the options above. They consider it would achieve the objectives while keeping an 'even playing field'.

    b. Banks and a legal advisor suggested that this option could be used in combination with Option Two to alleviate competition concerns (although, they did not agree with these concerns).

c. Consumer advocates consider this the highest risk option, citing that most of the unaffordable lending they see is at an interest rates below 30 percent. They consider this option highly risky and voiced concern about their ability to take adequate action against cases of unaffordable lending if this option was pursued.

d. Similarly, the Commerce Commission does not support this option due to the harm it continues to see with credit with interest rates below 30%, the fact this option would exempt around 95% of lenders, and the likelihood of lenders dropping interest rates below 30% while increasing fees to retain revenue.

Option Five: Revoke the affordability regulations (preferred by MBIE)

121. This option would be to remove the substance of the affordability requirements from the regulations and rely solely on guidance in the Code to support lenders in determining what inquiries are likely to be reasonable for the purposes of the CCCFA. The regulation creating a rebuttable presumption of unaffordability for high-cost credit contracts (Regulation 4AO) would be retained.

Benefits

122. This option has the greatest potential to reduce costs from unnecessary inquiries and improve access to affordable credit. It would afford all lenders discretion to assess affordability as they judge appropriate (against the legal standard of ‘reasonable inquiries’) in respect of all consumer lending. We consider it the option most conducive to lenders investing in improvements to their affordability practices because it would be straightforward to implement and is likely to be perceived by them as less exposed to disruption from further reforms during phase two (including a change in regulator).

123. This option would also maintain a level playing field for lenders.

Costs

124. We assess the risk of unaffordable lending associated with this option as very similar to Option Four with a 30% threshold. Although it includes the minority of credit products above a 30% interest rate (which have greater potential to harm consumers if unaffordable), it also better communicates to lenders that the appropriate level of inquiries into affordability are for them to judge (based on the circumstances and risk profile of the lending) against the test in the CCCFA and supported by the Code. Options that identify a subset of lending in order to disapply the regulations risk carrying the implication that the Government has determined that category of lending to be lower risk, such that less care is required in assessing affordability. That implication would increase the risk of unaffordable lending because the distinctions those options rely on (e.g. an annual interest rate) poorly predict this risk.

Stakeholder views

125. We have not directly consulted stakeholders on this option. However, we consider their views on Option Four with a 30% threshold (affecting almost all lending or effectively all lending if interest rates currently above that theshold are adjusted down) a reliable indication of their views on this option. Accordingly, we expect it to be supported by all lenders and opposed by consumer advocates. The Commerce Commission has also confirmed it does not support this option.

126. We would not expect any stakeholders to have the same concerns about this option’s impact on competition nor challenges with implementation that apply to Option Four.

How do the options compare to the status quo/counterfactual?

	No action	Option 2 – Disapply regs to deposit-takers	Option 3 – Disapply regs to home loans	Option 4A – Disapply regs to loans with int. rate below 15%	Option 4B – Disapply regs to loans with int. rate below 30%	Option 5 – Revoke regs (replacing with guidance)
Minimise costs to lenders and consumers from unnecessary inquiries and processing times	0	++ 16 banks and 15 non-bank deposit takers (6% of all lenders) would be able to reduce processing times and compliance costs for a reasonable proportion of new loans.	+ An estimated 43 lenders (8%) provide these products and could reduce processing times and compliance costs (e.g. for existing customers), but accounts overall for fewer loans than other options. Lenders might not make use of this option when processing home loans at the same time as unsecured loans.	++ Shorter processing times and compliance costs available as appropriate for a reasonable share of lending, including all home lending, and the cheaper portion of all other credit products. May place downward pressure on interest rates for products at the margins.	+++ Shorter processing times and compliance costs available as appropriate for almost the entire market (95% of lenders). May place downward pressure on interest rates above 30%.	+++ Shorter processing times and compliance costs available as appropriate for the entire market, including in the case of an emergency event.
Minimise cases where lenders approve unaffordable credit (avoiding false positives)	0	- Deposit-takers relaxing their levels of inquiry involves a risk of them becoming less effective at avoiding false positive – particularly if they relax inquiries for a greater range of borrowers. This risk remains difficult to predict. The nature, size and scrutiny of these lenders makes obvious or systematic errors less likely. However, commercial incentives and compliance with prudential/conduct regulation do not directly translate to avoidance of false positives.	0 Negligible change expected, given relatively low rate of arrears for home loans, nature of these borrowers, and the profile of lenders (being largely the same as for Option 2).	- - Presents an elevated risk of affordability processes failing to filter out unaffordable credit because it would bring in a larger number of lenders, each with their own processes and understanding of their obligations once regs are disapplied, and each competing with each other to attract borrowers (who value shorter processing times). Less than 10% of contracts successfully disputed by Christians Against Poverty had interest rates below 15%.	- - - Presents an even larger risk of increasing false positives given it creates opportunities for all lenders to reduce rigour of their processes in competition with each other. 90% of the Christians Against Poverty disputes concerned contracts below 30% interest.	- - - As per Option 4B
Minimise cases where lenders decline credit that is likely to be affordable (avoiding false negatives)[16]	0	+ Flexibility to exercise more judgment and consider full range of borrower circumstances relevant to affordability likely to reduce false negatives.	+ Flexibility to exercise more judgement and consider full range of borrower circumstances relevant to affordability likely to reduce false negatives.	+ Flexibility to exercise more judgment and consider full range of borrower circumstances relevant to affordability likely to reduce false negatives for a range of credit products.	+ Flexibility to exercise more judgment and full range of circumstances relevant to affordability.	+ As per Option 4B
Provide a level playing field for lenders to compete	0	- - - These lenders offer a range of credit products in competition with lenders whose processes would not benefit from the same flexibility. We would expect this to materially impact on competition across these products given borrowers value more timely access to credit.	0 No material Impacts on competition expected. Homeowners make use of home loan facilities for purposes that technically compete with products offered by other lenders, but mortgage facilities typically outcompete these other products (through lower interest rates and greater convenience). This option could make some marginal contribution to these borrower preferences (e.g. via shorter processing times).	- Would advantage lenders with products below the chosen interest rate over others (to the extent they remain). This impact on competition may benefit consumers by lowering prices or encouraging them to prefer lower priced credit. However, segmenting the market in this way carries a risk of unintended consequences. For example, it may reduce the availability of credit to less creditworthy borrowers by squeezing lenders who price risk into their interest rates.		0 We see no reason why this option would affect competition, provided the Code guidance remains product-agnostic.

[16] We have given options the same rating against this criterion, even as the proportion of lending affected by the options increases. This is because our evidence of false negatives associated with the status quo is limited to the practices of banks and we have no basis for expecting this benefit to scale as lenders with less sophisticated processes benefit from these options.

	No action	Option 2 – Disapply regs to deposit-takers	Option 3 – Disapply regs to home loans	Option 4A – Disapply regs to loans with int. rate below 15%	Option 4B – Disapply regs to loans with int. rate below 30%	Option 5 – Revoke regs (replacing with guidance)
Certainty and ease of implementation for lenders in advance of phase 2	0	- Registration and licensing requirements make this obvious who this option applies to, but some potential ambiguity in cases of assigned loans and subsidiaries. Relatively certain and easy for these lenders to apply across all their products.	- - Some thought required to appropriately define relevant loans, but at least as straightforward to apply as Option 2. Less certain and easy for lenders to apply with only a subset of their lending affected.	- - Could be costly for lenders to implement unless a simple legal test is used for determining the relevant interest rate (at a point in time). Less certain and easy for lenders to apply with only a subset of their lending affected (for at least some lenders).		0 This option avoids any complexity in specifying when the regs don't apply. We have assumed that Code guidance will give lenders the confidence to improve the efficiency and effectiveness of their processes over time.
Overall assessment	**0**	**-2**	**0**	**-1**	**-1**	**+1**

Key for qualitative judgments:

+++ significantly better than doing nothing
++ quite a lot better than doing nothing
+ slightly better than doing nothing
0 about the same as doing nothing
- slightly worse than doing nothing
- - quite a lot worse than doing nothing
- - - significantly worse than doing nothing

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

127. Our analysis of the options above, with equally weighted criteria, produces a marginal preference for Option Five. Option Five is the only option that improves on the status quo against the criteria. We have greater confidence in this option than any others that it would create the conditions necessary for lenders to adapt the way they assess affordability to address the problems identified with the affordability regulations. We therefore expect it to be a relatively effective solution.

128. We have weighed the effectiveness of this option against greater risk to consumers of harm caused by affordability processes that are more prone to false positives. This trade-off between better access to credit (fewer false negatives and reduced processing costs) and higher tolerance for potential false positives reflects competing interests of consumers recognised by section 3 of the CCCFA (essentially, 'protection' from problematic debt versus 'participation' in 'efficient' markets for credit). It is finely balanced in our analysis, and we have acknowledged uncertainty about the magnitude of risk to borrowers under Option Five.

129. However, we would not expect revoking the regulations to produce the same threat to borrowers that motivated their development in the first place. This is because the affordability regulations were accompanied by changes to the CCCFA that provide other protections against unaffordable lending. Notably, section 9CA requires lenders to make records of their affordability assessments and share these with the Commmission, the borrower or a dispute resolution scheme if requested. Some penalties for breach of the obligation to assess affordability were also increased in 2019, and liability for directors and senior managers created in 2021.

130. The role of the Code in supporting lenders to develop responsible and effective affordability processes could be another important difference with the regulatory environment in 2021. Providing effective guidance is one of the main ways we expect to mitigate the risk to borrowers under this option. In hindsight, we acknowledge that guidance that preceded the affordability regulations (the 2017 version of the Code) could have done more to help lenders understand what might constitute reasonable inquiries into affordability and have confidence they were ultimately complying with the CCCFA.

What are the marginal costs and benefits of the option?

Affected groups	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Regulated groups: all lenders (as defined by section 9B of the CCCFA)	Optional cost of adapting approach to affordability assessments for new lending. This could be one-off or incremental. Optional because change not required to comply with legal obligations.	Dependent on the size of the lender, nature and complexity of their systems and how much they choose to invest in adapting them. Could be quite significant (i.e. millions of dollars) for larger lenders e.g. banks.	We have a high degree of confidence in these statements.
The Commerce Commission	No material costs expected.	N/A	High based on consultation with the Commission.

Affected groups	Comment	Impact	Evidence Certainty
All consumers seeking credit (under a consumer credit contract as defined by section 11 and mobile traders) and funded service providers or charities who support them	Greater risk of lenders making insufficient inquiries to rule out unaffordable lending may translate to higher borrowing costs for consumers and financial stress in some cases.	We have assessed this risk as significantly higher than the status quo but lower than pre-2021 levels. We are unable on the information available to assess the likely scale of costs associated with this risk.	Costs not able to be estimated.
Total monetised costs	Costs to lenders of adapting processes	Some $ millions for banks	Low
Non-monetised costs	Increased risk of harm from unaffordable lending for some borrowers	Unknown	N/A
Additional benefits of the preferred option compared to taking no action			
Regulated groups: all lenders (as defined by section 9B of the CCCFA)	Optional changes to affordability assessments likely to deliver ongoing savings by reducing loan processing times in certain cases. We would expect most, if not all lenders, to enjoy these savings at some point.	Savings from reduced processing times will depend on extent to which each lender reduces their level of inquiries (including in what situations).	Medium from what lenders have told us.
The Commerce Commission	No savings expected.	N/A	High based on consultation with the Commission.
All consumers seeking credit (under a consumer credit contract as defined by section 11 and mobile traders) and funded service providers or charities who support them	Consumers are expected in at least some cases to benefit from improved access to credit in terms of more timely processing of their loan applications, fewer unnecessary inquiries and a slightly higher success rate. Consumers would also enjoy marginally lower borrowing costs if lenders pass on savings.	Low. Information provided by lenders suggests loan processing times could be halved in some cases (which we might expect for lower-risk lending that does not justify the level of inquiries prescribed by the regulations). Whether savings enjoyed by lenders are passed on would depend on the extent to which they compete on price. We have limited evidence of false negatives produced by the affordability regulations.	Low, given these benefits are theoretical and highly uncertain
Total monetised benefits	N/A	N/A	N/A
Non-monetised benefits	Above	Medium	N/A

131. Given revoking the affordability regulations would in some sense decrease regulatory burden, the change is purely permissive rather than imposing any transition costs on lenders. Lenders would effectively undertake their own analysis of net returns from changing their affordability processes. Our expectation (explained at paragraph 80) is that lenders would be commercially

motivated to change their processes for assessing affordability in the long-run based on their understanding of what is legally permissible.

132. The benefits noted above are predicated on this expectation of lenders changing their approaches to assessing affordability consistent with the policy intent, but it is not possible for us to meaningfully predict the scale of those benefits.

133. The risk that the proposal to remove affordability requirements increases the incidence of unaffordable lending, if realised, is likely to disproportionately affect certain population groups. These would be groups who are more likely to be seeking credit from less scrupulous lenders or who are more vulnerable, by being less well equipped to judge affordability of the credit themselves (due, for example, to low levels of financial literacy, a poor understanding of English, financial stress, or pressure from family members to obtain credit). Māori, Pacific peoples and immigrants are likely to be over-represented in these groups.

Section 3: Delivering an option

How will the new arrangements be implemented?

134. If Cabinet agrees to revoke the affordability regulations, this would be given effect by amendment regulations made in Executive Council later this year. Revocation would come into force 28 days after these amendments are published on the New Zealand Gazette or sooner if the 28-day rule is waived by Cabinet. The relevant regulation-making power requires consultation with parties likely to be materially affected by the change. We therefore intend to consult key stakeholders on a draft of these regulations before they are made.

135. We intend to use our established channels of communication to keep stakeholders informed of these developments, including publishing information on MBIE's website.

136. Implementation of the preferred option is largely a matter for lenders. It would enable lenders to adapt their processes for assessing affordability over time (both in their commercial interests and based on their understanding of the relevant obligation in the CCCFA).

137. We see the success of this option in fulfilling the policy intent and avoiding risks identified in this RIS as highly dependent on the development of effective guidance for lenders to support them in continuing to make the reasonable inquiries into affordability. The mechanism provided by the CCCFA for this purpose is the Responsible Lending Code, which is issued by the responsible Minister. We would develop revisions to the Code following the process prescribed by section 9G of the CCCFA. This includes consultation with affected parties and a minimum 28 day grace period.

138. We would coordinate the commencement of changes to the Code so that they are available to support implementation by stakeholders at the time the affordability regulations are revoked.

139. The Commerce Commission is responsible for enforcing the CCCFA. We note the Minister of Commerce and Consumer Affairs has recently announced his intention to transfer responsibility to the Financial Markets Authority. In any event, the Commission would be responsible during the initial period in which lenders are responding to the change to regulations. We would involve both regulators closely in the development of changes to the Code.

How will the new arrangements be monitored, evaluated, and reviewed?

140. We maintain good working relationships and open dialogue with a wide range of stakeholders affected by the preferred option. Our intention is to actively seek to understand their

experiences of the change at a meaningful stage after implementation. The timing of this would depend on how quickly lenders adapt their approaches to affordability.

141. We have procured a consumer credit survey that provides insights into borrowing over the 2023 calendar year. This will accompany other information and data sources we have available as benchmarks to monitor changes against, once amendments to the regulations are in force. Re-running the consumer credit survey at a meaningful point after implementation of the proposal would enable comparison across a range of metrics.

142. Many of the lenders we work with also hold data they are generally willing to share with us in order to identify particular trends.

143. To monitor the intended impacts of the preferred option, we would mostly be interested in:

a. loan processing times and costs to lenders

b. borrower experiences of the nature of inquiries made (e.g. how intrusive or onerous they are)

c. conversion rates for new loan applications (noting, however, that these are influenced by a range other factors)

d. lender observations about their ability to avoid false negatives (e.g. in exceptional cases where greater discretion is required to conclude the loan is affordable).

144. The unintended impact we intend to most actively monitor is the prevelance of assessments that fail to identify signs lending is likely to be unaffordable. We will also be interested to monitor how revoking the regulations has impacted the resolution of cases where unaffordable lending is alleged and redress sought. We would not expect these impacts to be observable as quickly as the intended impacts, given it often takes more than a year for issues with a loan to be attributed back to the process by which is was approved and longer for the resolution of any subsequent dispute.

145. To monitor any negative impacts, we would rely on a combination of information sources, including:

a. the Commerce Commission (e.g. complaints data and enforcement activity)

b. financial mentors, charities and other service providers who support indebted consumers

c. data from dispute resolution schemes.

146. The Government does not presently intend in the next phase of reforms to the CCCFA to revisit legal requirements relating to affordability. However, transferring responsibility for the CCCFA may provide a case for rethinking certain aspects of the CCCFA through a further reform process in future. We would assess the need for further policy development on affordability assessments in the event we see evidence of problems arising.