Submission on discussion document: *Fit for purpose consumer credit legislation*

Your name and organisation

Name	Non-Bank Deposit Takers (see below)
Organisation (if applicable)	Non-Bank Deposit Takers comprising: • Nelson Building Society • Wairarapa Building Society • Heretaunga Building Society • Unity Credit Union • Xceda Finance Limited • Finance Direct Limited • General Finance Limited
Contact details	c/- Buddle Findlay Attention: Simon Jensen and Rebecca Green ***simon.jensen@buddlefindlay.com*** ***rebecca.green@buddlefindlay.com***

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Introduction

This Submission is made by a group of non-bank deposit takers (**NBDT**s) (who are also consumer credit lenders).

Non-bank deposit takers are entities licenced under the Non-Bank Deposit Takers Act 2013 (**NBDTA**) who are actively supervised by statutory supervisors/trustees under trust deeds. Their business is comprehensively regulated both prudentially and in relation to conduct.

The NBDTs believe as a group that they are the ones most adversely affected by the consequences (some unintended) of this regime. They all have strong compliance cultures which are enforced by statutory supervisors without having the scale that the large banks do to spread the costs associated with poorly targeted regulation. As the Commerce Commission (the **Commission**) had noted in its draft report on its market study into the personal banking market in New Zealand, this regulation, including specifically the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) is unquestionably affecting non-bank deposit takers' ability to compete with the large banks and is part of the reason we have an oligopoly in New Zealand.

In practice, the NBDT group is categorised by high levels of customer satisfaction because this is how they have to differentiate themselves from the large banks. However, they believe their ability to provide good customer service is in fact impeded by prescriptive, poorly targeted regulation. Increasingly, they are in a position where they struggle to do the right thing by the customer because the regulation is not sufficiently customer-focused.

The NBDTs believe that the CCCFA is an example of poorly targeted, overly prescriptive regulation. It is supposed to have a consumer protection role and yet is not easily comprehensible to most consumers. The number of highly technical cases brought under the CCCFA against virtually all major banks is a clear indication the legislation is too complex and ambiguous.

While the NBDTs believe the CCCFA needs a comprehensive overhaul, the discussion document has at least identified some key issues which do need to be fixed. Ultimately the NBDT group believe that the CCCFA should focus on:

- actual customer harm;
- empowering customers, by focussing on request disclosure when dealing with agreed variations, enabling customers to decide if they want information;
- providing fair remedies for customers, compensating them for actual harm - not theoretical harm; and
- enabling easy access to justice for customers - in practice through free access to dispute schemes equipped to provide fair and effective remedies for customers.

The NBDTs believe the most impactful changes that can and should be made to the CCCFA are:

1. **Remove the requirement for agreed variation disclosure**. When customers ask for and are given variations to their original agreement they should simply be advised of the change made and of their right to seek and get financial information from their lender so that they can check the impact of the change they have requested. A large number of agreed variations are simply the refixing of interest rates after a fixed rate period has ended where the customer has no choice but to continue the loan and is only concerned about the interest rate change. Another common change is in payment frequency which is typically to line up with the frequency of the

customer's pay. The NBDTs cannot recall a single example of a customer asking to 'reverse' an agreed variation following disclosure.

2. **Remove the cost of borrowing penalty**. The cost of borrowing as a penalty is disproportionate. Almost universally customers will have suffered no (or little) harm as a result of a disclosure failure. There is no plausible requirement for a penalty as severe as the cost of borrowing penalty – it is completely out of step with all other penalties in New Zealand legislation. This is particularly so where there is no evidence to the NBDTs' knowledge of actual consumer harm from disclosure failure. Any prejudice is, for the most part, purely theoretical.

3. **The liability for directors and senior managers for failing to undertake due diligence adequately is inappropriate in a statute regulating consumer lending**. The approach should be the same as is the case in the Financial Markets Conduct Act 2013 (**FMCA**) – namely the primary penalty should be against the organisation with directors and senior managers only liable if they were complicit in the breach.

The NBDTs strongly urge MBIE to work with banks and non-bank deposit takers to survey customers to identify:

- what percentage of them actually read disclosure statements;
- how often customers change their mind based on disclosure statements; and
- which parts of disclosure statements, if any, customers have found valuable.

Based on the NBDTs' experience, the disclosure regime adds little value for customers. What is more important is that the original advertising and product documents are clear and concise and that customers have access to advice explaining the financial impacts of the products.

This submission addresses some, but not all, of the points raised in the discussion document. In some cases, responses in one area might be contingent on (or highly relevant to) outcomes in other areas.

The focus of this response is part 2 of the discussion document (*Options to amend disclosure requirements*), with views also being expressed on matters in part 1 (*Options to amend the CCCFA to enable the FMA to carry out its role effectively*).

Responses to discussion document questions

	1. Options to amend the CCCFA to enable the FMA to carry out its role effectively A. Options for liability settings
1	*Do you have any evidence or experience of the due diligence duty and personal liability resulting in overly conservative approaches to complying with the CCCFA? What impact did this have on consumers? How common do you think this is?*
	The NBDTs think that describing practices as "overly conservative" is unfair in the context of CCCFA compliance. Lenders (and directors and senior managers of lenders) are acutely conscious of a number of weighty factors that currently influence this industry, including: • the watering-down of customer responsibility (for example, the repeal of s9C(7)); • a focus by regulators and dispute resolution schemes which has favoured the purposes in section 3(2)(a) and (c) to the detriment of 3(2)(b); • the ambiguity, complexity and rigidity of parts of the CCCFA (including disclosure); • the uncertainty and risk associated with reporting and/or attempting to remedy breaches; and • the draconian and disproportionate penalties for breaching sections 17 and 22 (eg. section 99(1A)). This results in a regime which is overengineered for the majority of lenders and customers, to solve issues which affect only a very small portion of the industry. The regime is dense and difficult even for expert lawyers to understand (demonstrated by the huge costs of compliance in the large institutions). The NBDTs think it is inevitable that lending practices in this environment will be cautious. If they are considered 'overly' so, that is primarily a problem with the regime and its consequences. If MBIE want to see a change in approach, they need to make the CCCFA understandable. Like all New Zealanders, the NBDTs have seen increased conservative practices in all of the lending sector, in relation to affordability assessments. They have also seen lenders make decisions to discontinue products, move away from consumer lending entirely, and/or to adapt products to remove certain borrower flexibility or functionality, due to difficulties/risks/costs with trying to comply with rigid disclosure requirements. Compliance costs have materially increased for lenders and continue to do so. This disproportionately impacts NBDTs and smaller lenders. They NBDTs have seen some lenders significantly increase their compliance personnel in the last 5+ years, very few (if any) of which are in customer facing roles. All of this means more costs and less options for consumers. The NBDTs do not believe that imposing due diligence requirements on directors and senior managers creates better incentives for compliance. Most directors accept they have a responsibility to ensure their organisation's compliance, whether or not they are personally liable. While they agree that making directors and senior managers personally liable has contributed to a conservative approach to interpreting the legislation, this has not occurred in isolation. The problem includes overly complex and poorly considered regulation (with

	unintended consequences) and disproportionate penalties for getting it wrong (even where there is no discernible prejudice to customers). Moreover, the NBDTs think it is wrong to make directors and senior managers liable for a regime which is too complex, difficult to comply with (even for the most well-resourced lenders), ambiguous and inconsistently remediated. For this reason alone, the NBDTs support repealing s59B. If personal liability is to be retained, the regime needs to be materially simplified. The approach should be the same as is the case in the FMCA – namely the primary penalty should be against the organisation with directors and senior managers only liable if they were complicit in the breach.
2	*Do you have any observations about how the impact of the due diligence duty and personal liability works may or may not depend on the size of the lender?*
	Smaller lenders are more likely to rely on a smaller compliance team (proportionately) who ensure compliance through manual, semi-manual or less sophisticated automated processes. Sophisticated IT systems which are used by larger lenders (and which are very expensive to implement and upgrade) in conjunction with proportionately larger compliance teams, may offer directors and senior managers of larger lenders more compliance assurance. There is also a sense that directors and senior managers of smaller lenders are (or should be) 'closer to the action' and so should have a heightened awareness of compliance as opposed to directors or senior managers of a larger lender. That effectively puts a higher onus on directors and senior managers of smaller lenders, which the NBDTs think creates additional barriers to competition. Personal liability means directors and senior managers, particularly of NBDTs which also have other compliance regimes under the FMCA (including their trust deed) and NBDTA to comply with, are either likely to require higher remuneration in their roles or want the lender to take a strongly risk averse approach. This could disproportionately impact the ability and/or costs of smaller and regional lenders to attract and retain people in those roles and will affect the lender's appetite for competition and innovation.
3	*Are you aware of any other problems with these liability settings?*
	As above, the NBDTs think it is wrong to impose personal liability on directors and senior managers in circumstances where parts of the CCCFA (particularly, variation disclosure) are ambiguous, complex and notoriously difficult to comply with. The discussion document includes footnote 3 which provides that pecuniary penalties are required to be proportionate to the harm caused by the contravention. While this is sound in theory, in general, the concept of harm under the CCCFA is underdeveloped and inconsistently applied. In the NBDTs experience, it is very rare for a CCCFA breach (particularly as pertains to disclosure) to have caused any financial harm and arguably little or no prejudice at all. However, such breaches appear to frequently carry significant remediation costs and penalties for lenders. As such, suspect that directors and senior managers are likely to be sceptical of any assurance that remedies under the CCCFA in general (whether remediation or penalties), will be proportionate to harm where there is insufficient evidence as to what harm is actually caused.

Option A1: Retain the due diligence duty but remove restrictions on indemnities and insurance (preferred)	
4	*If lenders were able to indemnify their directors and senior managers from liability for pecuniary penalties (and costs), what difference (if any) would you expect that to make to how those individuals and the company as a whole approach the due diligence duty?*
	The NBDTs do not expect the ability to indemnify directors and senior managers for pecuniary penalties (and costs), to impact the approach of the majority to due diligence. They believe that lenders, and directors and senior managers of lenders, are also likely to be concerned about reputation and the impact of regulatory breaches (including s59B) on the business and their professional standing, which will motivate the vast majority of lenders (and directors and senior managers) to ensure compliance regardless of whether they can be indemnified for pecuniary penalties. While the NBDTs think it is unreasonable not to allow indemnity and insurance (consistent with other acts relating to directors' duties), it should only affect directors' and senior managers' remuneration and perhaps risk appetite, but not fundamentally compliance with obligations to undertake due diligence.
5	*If insurance were available for pecuniary penalties liability, what difference (if any) would you expect that to make to how directors and senior managers and the company as a whole meet their due diligence duty? Do you have any information about how affordable that insurance might be for different types of lenders?*
	Allowing lenders to insure their directors and senior managers for pecuniary penalties liability may assist lenders, particularly smaller lenders, to attract and retain directors and senior managers. As above, the NBDTs would not expect it to make any material difference to how the majority of lenders approach the due diligence duty. The NBDTs do not expect that the costs of insurance would be passed on to consumers. Instead, they believe that consumers could be better off, if it enables a simpler and more balanced approach to risk to be taken.
Option A2: Remove due diligence duty for licenced lenders	
6	*Do you agree that the due diligence duty is less likely to be needed for lenders who are sophisticated enough to be licensed under the CoFI Act? Why/Why not?*
	Yes, those lenders are required to have conduct and risk programmes which effectively address the issue. They have already been through suitability tests and are actively monitored by regulators (currently through trustees but in the future, directly). NBDTs are required to make regulated offers under the FMCA for their ordinary/everyday debt securities (which registered banks are not). NBDTs already have a strong compliance culture which incentivises the organisation, and its directors and senior managers, to comply with law (generally). They should get the benefit of being regulated.
7	*How well do you think licensing and ongoing supervision by the FMA could replace the need for due diligence and personal liability? Does this depend on the kind of lender? If so, how?*
	The NBDTs do not advocate for a licensing model (see responses below).

8	*What impacts might options A1 and A2 have on lenders and consumers compared to the status quo? For lenders, how would you expect lender decision-making and compliance cultures to change under these options?*
	See responses in questions 1 to 7 above.
	B. Options for regulatory model
9	*Do you agree that these are a fair reflection of the minimum legislative changes that are required to transition credit to the FMA? If not, please explain*
	The extension of 'core' Financial Markets Authority (**FMA**) enforcement provisions to consumer lending would need to be very carefully tailored to avoid unintended consequences. For example, the discussion document suggests that the FMA should have the power to issue 'stop orders' (which is an out-of-court process) on non-compliant CCCFA disclosure statements, banning distribution and/or prohibiting the lender from supplying credit. This is a potentially draconian power which the Commission does not currently have (the Commission would need to go to court for a similar outcome). The same applies to directions. The discussion document seems to view this as an advantage – the fact that the FMA could use its licensing powers (action plans, stop orders, directions) as administrative functions, without the need for court orders, "*would allow the FMA to undertake proportionate market conduct interventions*"[1]. The suggestion is that obligations under the CCCFA will become market services licensee obligations, which seems to treat all obligations under the CCCFA as having equal significance as current market services licensee obligations, and attracting the use of the FMA's expansive licensing powers in response. The NBDTs question whether that is necessary or desirable.
Option B1: Transition to a market services licence and apply all FMA core and licencing powers to consumer credit (preferred)	
10	*What implications would you expect from adopting a licencing approach and the associated regulatory tools for credit?*
	The licensing process in Part 6 of the FMCA is fundamentally designed around protecting the interests of investors, rather than borrowers. Investors are financially exposed to the loss of their capital/return if the provider of the market service (scheme manager; DIMs provider; derivatives issuer; FAP provider; financial product broker) mismanages that ongoing service, and so requiring a market service provider to: a) demonstrate they are capable of effectively performing that service; and b) that there is no reason to believe they will not comply with their licensee obligations, makes sense. Borrowers are not exposed to that risk – they are borrowing money, not investing it. The NBDTs believe that forcing consumer lending into the market services licencing regime in Part 6, would be a 'sledgehammer to crack a nut'. This would appear to be driven not by principle but by expediency/ease of process for the regulator (the FMA). The NBDTs query why the same toolkit available to the FMA couldn't simply be available in respect of the

[1] At para 43 of the discussion document.

	provision of credit, without having to shoe-horn credit into Part 6. The logically prior question – is it even necessary to *licence* consumer lending – does not seem to be asked in the discussion document. The assumption in the discussion document is that licencing will "*help to create a fair, efficient, and transparent market for consumer credit*"[2]. However, there is no evidence that this is the case, or that this is the purpose of licencing, or that it will be any more effective than the current system under the CCCFA, which relies on initial disclosure to borrowers (so as to allow comparison between lenders). Licencing will obviously create further regulatory barriers to entry (and cost – the cost of obtaining market services licences currently is high, and a time-intensive process), and stifle further innovation. The discussion document seems to acknowledge this at para 37, but then does not revisit the issue. It seems odd for there to have been criticism by the Minister of CoFi (as to 'too much regulation') and to then suggest a new licencing regime for consumer lenders. The current certification process under the CCCFA, by comparison to Part 6 licensing, is a 'light touch' approach which focuses on one aspect – whether directors and senior managers are fit and proper persons (with the aim of weeding out irresponsible/predatory lenders), and conditions are not usually imposed. Many of the standard conditions imposed on market service providers – such as business continuity plans, outsourcing arrangements, reporting etc – are for the purpose of investor protection (see above), and are irrelevant for consumer lenders. If the only condition under a consumer lending licence will be fit and proper directors/senior managers, the NBDTs query what the transition to a market services licence achieves. The one standard reporting condition (in regulation 191 of the FMC Regulations) is again focused on investor protection (ie. notifying the FMA if there may be an insolvency event, or if proceedings are taken, etc).
11	*What modifications to the FMA's existing regulatory tools, such as stop orders, should we consider if extending them to the CCCFA under this option?*
	See the response in question 9.
12	*What do you think about the transitional licence approach, including what time periods are appropriate?*
	The NBDTs do not generally support a licensing approach.
Option B2: Retain 'Fit and proper' certification (status quo) and add FMA core tools for enforcing the regulatory perimeter	
13	*Do you agree with our analysis about the relative benefits and risks of the certification model? Why/ why not?*
	The NBDTs agree that the current certification model creates lower barriers to entry for creditors to enter the market, which is a good thing where it helps to facilitate innovation, competition and diversity. By reference to the recent Commerce Commission's study into personal banking services, that purpose should be elevated amongst the other purposes of the CCCFA (so that it is at least equal in significance).

[2] At para 36 of the discussion document.

14	*Are there additional tools that you consider the FMA should have to regulate credit, for examples tools like action plans or censures that are usually only available under a licensing model?*
	See the response in question 9.
	2. Options to amend disclosure requirements
	C. Options for what and when information must be disclosed
15	*As a consumer, do you receive the right kind and amount of information to make informed decisions? Why/why not?*
	This question needs to be examined in much more granular detail across each disclosure type. Behavioural economics would suggest that many or even most consumers don't read or act on disclosures. As noted in the Introduction to this submission, the NBDTs strongly urge MBIE to work with banks and non-bank deposit takers to survey customers to identify: • what percentage of them actually read disclosure statements; • how often customers change their mind based on disclosure statements; and • which parts of disclosure statements, if any, customers have found valuable. Based on the NBDTs' experience, the disclosure regime adds very little value for customers and in some cases, detracts from good customer experience. What is more important is that the original advertising and product documents are clear and concise and that customers have access to advice explaining the financial impacts of the products.
16	*Do you consider any of the disclosure obligations to be irrelevant, confusing, or inappropriate? If so, please tell us what obligations you are referring to and what impact this has.*
	Yes, variation disclosure obligations in particular are ambiguous, complex and in some cases, irrelevant. This is particularly so for agreed variations, which simply involve changes a customer has asked for, such as a new fixed rate or payment frequency. "Corrective disclosure" (where a lender rectifies an error in variation disclosure) is also problematic for both lenders and customers, which can make remediation of any error complex, difficult and expensive. The NBDTs explain their concerns in paragraph 5 of the submission below under *Other Comments.* The NBDTs know that lenders have, in some cases, shifted resources and focus towards non-CCCFA lending, in large part as a result of the impact of poorly considered, or unintended consequences of, CCCFA regulation. This includes mandatory disclosures (particularly variation disclosure), but also includes responsible lending provisions (generally, but particularly affordability), complexity around calculation of compliant fees and heavily prescribed processes generally. This has reduced existing competition for consumer lending as providers move towards business lending which has lower compliance risks and higher profitability. This dynamic continues to add barriers to new providers entering the market, at a time when the lack of competition should be in the political spotlight.

	The NBDTs more specific concerns with sections 22 and 23 are set out in the submission below in paragraphs 1 to 7 under *Other Comments*.
17	*How could disclosure obligations be more targeted to the consumer's circumstances to ensure only relevant information is disclosed?*
	The NBDTs strongly oppose any requirement for lenders to actively target disclosure to consumer's circumstances. This will create materially more uncertainty and compliance burden and there is simply no evidence (from the NBDTs' customer base) that it would even be read. The NBDTs think that the best way for disclosure to provide the information a customer requires, is for a lender to make certain basic mandated disclosures (other disclosures could also be made voluntarily) and to allow the customer to request what further information they need/want (with certain guidance from the lender) under section 24. The NBDTs further explain their concerns in paragraph 3 of the submission below under *Other Comments*.
18	*Is the information set out in Regulations 4F and 4G both sufficient and do sections 22 and/or 23 require the right information to be disclosed when a contract is varied?*
	There now appears to be a mismatch between the information required to be disclosed under regulation 4F versus regulation 4G. For example, regulation 4F requires only forward-looking analysis for *total [future] interest charges* (regulation 4F(2)(f)) and the *total [future] amount of payments* (regulation 4F(2)(h)(iii)) for loans of 7 years or less. However, those equivalent disclosures which, according to the Commission's interpretation of "*full particulars of the change*" are required to be disclosed under s23 (schedule 1 matters) have no forward-looking element. That means the lender is required to disclose total interest charges and total amount of payments for the whole term of the contract (not just forward looking) when making a section 23 change. There is no apparent principled reason for that mismatch. Technical and interpretation issues aside (there are many), the NBDTs think that the most material problems with sections 22 and 23 are not whether they require disclosure of the 'right' information, but rather: • whether that information is used by customers; • the required timing of the disclosure (before the change takes effect); • understanding exactly what is required under section 22 in specific change scenarios; • trying to correct any errors that occur with adequate certainty; and • the disproportionate penalties for breaches. The NBDT's explain their concerns further in paragraphs 1 to 7 of the submission below under *Other Comments*.
19	*Are there any other concerns or issues you would like to raise related to disclosure obligations?*
	As above and in paragraphs 1 to 8 of the submission below under *Other Comments*.
	D. Options for how information must be disclosed

20	*As a lender, do you identify any barriers in the Act to the use of electronic methods of disclosure? If so, can you explain what are these barriers and how they impact your processes?*
21	*As a lender, are there any practical difficulties with obtaining the borrower's consent for electronic forms of disclosure (section 32(4)(b))?*
22	*What would be the implications of removing the requirement to obtain borrower's consent for electronic communication and forms of disclosure (section 32(4)(b))?*
	E. Options for penalties for incomplete disclosures by lenders
23	*Do sections 95A and 95B meet their objectives? Why/why not?*
	No, sections 95A and 95B are too onerous for lenders. Seeking relief from a court is very expensive, disproportionately so for smaller lenders. The consequence is wrong to start with, along with the mandatory requirement to repay cost of borrowing. This, to the NBDT's knowledge, has no equivalent in any other legislation.
24	*As a lender, to what extent does section 99(1A) impact the time, effort, and costs you dedicate to initial and variation disclosures?*
	Section 99(1A) materially impacts the time, effort and costs dedicated to initial and variation disclosure. This can create an imbalance in the amount of time, effort and costs a lender spends on variation disclosure in particular, compared to other CCCFA processes, particularly where compliance resources are more limited as may be the case for smaller lenders. In the absence of evidence that variation disclosure (in particular) is relied on by customers, this imbalance is unwarranted. It creates a focus on dealing with a very prescriptive process, which diverts attention from spending time actually helping customers.
25	*Under option E1, what should a materiality test look like?*
	The NBDTs oppose the idea of any materiality or 'potential to mislead' test when applying s99(1A). The submission notes that "*How exactly this test is formulated would largely be a matter of drafting*". The NBDTs think that this kind of prescription is problematic under the CCCFA. There is a broad range of different lending products captured by the CCCFA (and more variety which could come to market to increase customer choice and competition, if the regulatory environment was right). Not only do sections 17 and 22 CCCFA apply to varied and emerging lending products and changes to those lending products, but they are received by customers who are in a wide variety of circumstances (some of which the lender may not even be aware of). This is not conducive to a materiality test, which would presumably need to be applied in a bespoke fashion but across what could be many contracts and many customers. The NBDTs do not think it is desirable for either the lender or customer to have the burden of proof in this matter, but of the two, they think the customer is better placed to bear that burden in relation to their own circumstances.

For the same reasons, the NBDTs oppose any requirement to prove harm or prejudice (including that the breach had the potential to mislead). Harm or prejudice (including being misleading) is likely to be highly subjective in this context. In our view, there is not enough evidence to conclude that customers read or rely on (and so could have been misled by) variation disclosure as a group, so as to warrant the retention of section 99(1A).

Introducing any kind of materiality test risks swapping existing ambiguity for new ambiguity. The regime needs to be simplified to achieve the desired outcomes expressed in the discussion document. Fundamentally, the consequences of failing to make disclosure are grossly disproportionate to the harm created (generally none) and out of step with remedies under other legislation.

26 *Under option E1, which party should have the burden of proof and what would this mean for the effectiveness of the option? If the onus is on borrowers to show materiality would that deter them from seeking redress under section 99(1A)?*

See response to question 25 above.

27 *Under option E2, how should the maximum amount the lender forfeits be calculated?*

The NBDTs do not think the maximum amount payable under s99(1A) should be calculated as a fixed amount as this would clearly advantage larger lenders. If a similar approach was taken to say, price fixing (which is generally regarded as a much more serious offence), then the cap should be based on a multiple of the gain made by the lender. This would be the **lending margin less associated costs** applied across the number of loans affected.

A cap is infinitely better than no cap, as it will reduce the possibility that a potential liability associated with a breach of sections 17 and/or 22 could financially threaten the existence of a lender. The fact that this dynamic can even exist in theory creates unacceptable stability risk in the sector for which the regulators ought to be concerned. For that reason alone, the NBDTs think any introduction of an appropriate cap on liability (or any repeal of s99(1A)) should be retrospective.

Even with the introduction of a cap on liability, the NBDTs think this still has the potential to be disproportionate where an omission or failure is minor but has occurred across a large number of contracts. In the absence of a materiality or harm test (which they oppose due to its likely complexity), if section 99(1A) is to be retained (which they also oppose), the better approach would be to introduce a cap on liability (calculated as described above) in conjunction with materially simplifying the disclosure requirements, so that the risk of s99(1A) liability arising from an 'immaterial' breach is materially reduced.

28 *Under option E3, would there be the right incentives in place to ensure lenders comply with their disclosure obligations?*

The NBDTs support the repeal of sections 99(1A), 95A and 95B for reasons explained throughout our submission. Given the very significant risks that s99(1A) can impose on the stability of the lending sector, this repeal should be retrospective (or at least additional relief allowed for retrospectively). It is simply disproportionate and out of step with the consequences or penalties in any other legislation.

The NBDTs think that the remaining enforcement provisions in the CCCFA (including statutory damages) should be adequate to incentivise compliance. They do not think there is a principled reason to set section 17 and, particularly, section 22 apart from the remainder of the CCCFA obligations, in such a dramatic fashion as occurs under s99(1A). The NBDTs note that the current cap on statutory damages in s89(1)(d) in relation to a breach of sections 17 or 22, is well in excess of most remediation sums paid to borrowers to date under documented settlements with the Commission (meaning the current provisions should be adequate to appropriately compensate borrowers where required). In their view, the circumstances where a cost of borrowing refund is appropriate are likely to be extremely limited (e.g perhaps only in relation to a fundamental breach of s17).

There is a statement in the discussion document which says "*some lenders only began paying due attention to their disclosure obligations because of section 99(1A)*"[3]. There will always be some lenders on the fringe of compliance, however the actions of (presumably) a very small minority should not materially increase the compliance burden, including costs and customer experience for all consumers, across the entire sector.

The discussion document also says section 99(1A) was introduced to ensure lenders do not **profit** from borrowing decisions. However, s99 goes well beyond lenders' "profit" and in fact penalises them for all **revenue** (interest and fees) earned on loans. That amount is typically many multiples of actual profit. So if section 99(1A) was designed to prevent lenders profiting from non-disclosure (as is said), it should at the very least ensure it does that (and not something well beyond that).

Non-bank deposit taking lenders are licenced under the NBDTA and are actively supervised by statutory supervisors/trustees under trust deeds. Their business is already comprehensively regulated both prudentially and in relation to conduct (which will increase under CoFI). NBDT lenders are already sufficiently incentivised to comply with all of their legal obligations, including CCCFA disclosures

29 *What would be the risks associated with each option? How could they be mitigated?*

The risks of retaining section 99(1A) are already discussed above and further below in the submission. The NBDTs consider the risks of retaining this section far outweigh any risks associated with repealing it.

Ways to mitigate risks include:

- limiting liability to profit (and capping it) if s99(1A) is retained;
- retaining existing CCCFA penalties for breach of disclosure requirements if s99(1A) is repealed; and

making any changes to s99(1A) (including its repeal) retrospective.

3. Review of the high-cost credit provisions

30 *What specific provisions (high-cost or other) have most impacted lenders' willingness or ability to offer high-cost consumer credit?*

[3] At para 86 of the discussion document.

31	*In the absence of high-cost loans, what other avenues are borrowers turning to?*
32	*Is the unavailability of high-cost consumer credit having positive or negative effects on would-be borrowers?*
33	*What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 30 per cent to 49.9 per cent?*

F. Options to amend the high-cost credit provisions

Option F1: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 30 per cent

34	*Are there any other issues associated with loans in the 30 per cent and 50 per cent interest rate range that we should be aware of?*
35	*Are there examples where loans with interest rates between 30 per cent and 50 per cent would breach the 0.8 per cent rate of charge cap?*

Option F2: Expanding the definition of a high-cost consumer credit contract to contracts with an interest rate above 45 per cent

36	*What evidence, if any, is there of debt spirals and/or continued repeat borrowing for vulnerable borrowers across credit contracts with interest rates of 45 per cent to 49.9 per cent? Are there any other issues associated with loans in this interest rate range that we should be aware of?*
37	*For lenders: If the government extended the high-cost provisions to loans with annual interest rate of 30 per cent or more, what would be the impact on your operations (if any)? Are there any changes to the high-cost provisions we should consider to enable those loans to remain profitable, and on what terms?*
38	*How is a revised definition of a high-cost consumer credit contract interest rate threshold likely to affect access to credit for borrowers?*
39	*Do you recommend considering another interest rate threshold? If yes, please explain why.*

Option F3: Status quo	
40	*Do you have any other feedback on any of the high-cost credit provisions? Have they been effective in reducing financial harm caused by the excessive cost of credit for some types of loans and repeat borrowing by vulnerable consumers?*
Option F4: Other high-cost provisions	
41	*Is there evidence of certain industry lending practices that are causing harm which the high-cost credit provisions could address?*
42	*Are there any other industry lending practices that you believe are harmful to consumers?*
43	*Do you agree with the suggested impacts of each of the identified options? Why/why not?*
44	*Do you have any information or data that would support our assessment of the impacts of each of the options?*
45	*Do you think that the CCCFA could be strengthened to protect consumers who are sold lending products or add-ons that exceed the value of the product? If so, how?*
46	*Finally, are there any other areas and options for change that we should consider that have not been addressed in this discussion document?*

Other comments

The following is further commentary on some of the issues with variation disclosure in particular. It is given in response to the option to streamline and clarify information required (option C3), however the NBDTs do not support that action being taken *'without changing the approach'* (as stated in the discussion document). Rather, they believe the approach to variation disclosure in particular, should be changed and not just tinkered with.

1. *The problem(s)*

1.1 The variation disclose regime in sections 22 and 23 (s22 in particular) is difficult to interpret and implement. Lawyers and regulators alike find these sections challenging to interpret with sufficient certainty. That itself should be illustrative of how difficult lenders find these provisions in practice. It is also fundamentally wrong that a statute that for the most part is designed to provide consumer protection is so complex and difficult to understand. Given the very material implications of getting it wrong, even where the error is minor, technical and/or inadvertent, the status quo should not be retained.

2. *Too prescriptive/complex/expensive to comply*

2.1 As the regime has become more and more prescriptive, including through ad hoc amendment, this had led to increased uncertainty over the exact meaning of the provisions and, accordingly, what is required. Coupled with draconian, disproportionate penalties for breaching agreed variation disclosure requirements, personal liability for directors and senior managers, and no real recognition of the concept of 'substantive' compliance, lenders are faced with taking extremely conservative paths that ultimately detract resources from customer-facing roles and increase compliance costs for all customers. This is an unsatisfactory outcome and does not promote the purpose and intent of the CCCFA in section 3(b) of the Act.

2.2 The documented (and undocumented) difficulties with agreed variation disclosure are numerous. Most difficulties arise because of an insistence on trying to prescribe the information that must be given to customers when a change is made. This one-size-fits-all approach to disclosure does not fit all and is difficult to interpret and apply across different lending products and different requests for variation.. As a result of the risks associated with non-compliance of agreed variation disclosure in particular, innovation and customer functionality in lending products is ultimately stifled. Lenders are increasingly disallowing borrowers flexibility in structuring and use of lending products because of a fear, real or otherwise, that they may not be able to comply with the prescriptive variation disclosure requirements or that it will be prohibitively difficult or expensive to do so within the limitations of their existing IT systems. This could be as simple as not allowing customers to change payment frequency, or requiring that change to be delayed, or not allowing a fixed rate roll-over to be backdated, because of the compliance costs and risks of doing so. That must be a bad thing for customers. The NBDTs have seen loan products discontinued or not brought to market for the same reasons.

2.3 Fundamentally, the NBDTs think that the content of mandatory agreed variation disclosure should be removed or materially reduced in favour of request disclosure only. Other financial markets legislation has focused on reducing extraneous information and duplication. A good example is risk disclosures in product disclosure statements, which are now materially shorter than they were in the past. What has been removed is extraneous, less significant, less likely, more generic disclosures which may still be relevant to an investor, but only peripherally so. These have been removed in favour of information which is deemed more specific and important.

3. *Timeliness and reliance*

3.1 We think that the difficulties with agreed variation disclosure and the industry's frustration with it are inflated by a general cynicism as to its usefulness. To the NBDTs' knowledge, there is no conclusive evidence that customers even read, let alone rely, on these disclosures. Many customers who receive variation disclosure by post will not have even physically received it before the change takes effect, even where it was made 'in time' (ie. before the change takes effect). While many disclosures are made electronically (especially for larger lenders), the NBDTs are not aware of any substantive evidence that shows how many are even read at all, let alone before the change takes effect. On the rare occasion that a customer receives variation disclosure, reads it and, as a result, wishes to make a different choice, the NBDTs expect most if not all lenders would allow that subsequent change to occur (whether or not it is before the (original) change took effect) even though technically borrowers do not have the *right* to make agreed variations.

3.2 The requirement to make agreed variation disclosure before the change takes effect is problematic for lenders for a number of reasons, including because there is real ambiguity over when a change actually takes effect. Different variations have different effects depending on the particular lending product. Timing for some variations is relatively straightforward. For example, a change in an interest rate takes effect when the interest calculations start being made at the new rate. However, the timing of other changes is less clear when the change is forward looking (ie. does the change take effect when it is made in the banking system, or when it first impacts on the contract/customer).

3.3 To be able to make disclosure before a change takes effect (which technically means at least one working day before) requires a certain level of predictive sophistication in banking IT systems which has caused unnecessary complexity and cost, and in some cases, breaches, across the industry. For many lenders, the variation disclosures required (particularly, the effects of the change) cannot be calculated until the change is entered in the banking system. If the change takes effect at that point, the disclosure is already too late. Entering changes which will take effect on some forward looking date (and predicting the effects of those changes) is complex and creates other timing challenges.

3.4 The NBDTs' preference would be for mandatory variation disclosure to be removed, in favour of some form of request disclosure. However, if mandatory agreed variation disclosure is to be retained in some form, they advocate for any required disclosures to be made in every case within 5 working days of the change taking effect (with additional clarification as to when the change takes effect, if required).

3.5 Some of what is required to be disclosed for variations is not useful to the average borrower. While the NBDTs' preference would be to remove mandatory variation disclosure, if it is to be retained in some form, they think consideration should be given to identifying a small group of key disclosures that should be made (after the change takes effect), where applicable, with the remaining disclosures (whatever is retained) to be made as request disclosure (under the existing request disclosure regime in the Act). The mandatory disclosures could be limited to, for example, the change itself and any change in the borrower's regular payment amount. Lenders could also disclose other information they think may be relevant on a voluntary basis (to reduce the number of enquiries they receive from customers). Finally, lenders could then be required to state that further information is available on request under section 24. Additional generic warning statements could be considered, such as a note to the effect that certain changes can increase the overall interest payable and if the customer wants more information, they should request it from the lender. Similar changes should be made to variation disclosure for guarantors.

3.6 The NBDTs do not agree with the option in C2 that lenders be required to identify what might be material information to a customer for agreed variation disclosure purposes. To illustrate simplistically, customers are unlikely to need or want to know the number of payments they have remaining on their 25 year loan, 2 years in (this is a regulation 4F requirement) but might be more interested in that information towards the expiry of the loan. Ultimately in this scenario, borrowers have typically asked for the variation (where it is an agreed variation), so it should be up to them to decide if they need any disclosure to help with any associated decisions relevant to that variation.

3.7 Any requirement for lenders to use discretion or overlay some loosely defined materiality threshold must be treated cautiously, as this has a real potential to increase (not decrease) regulatory burden, uncertainty and risk. Ultimately, what is material to a customer is whatever the particular customer wants to know about their loan at that particular time. As above, the NBDTs think that is a determination best made by the customer themselves, on request.

3.8 The impact of poor regulation is felt not only by the NBDTs, but by their customers as well. It is getting harder and harder to provide good service and achieve the historically high customer satisfaction levels that the NBDTs are known for, due to the necessary diversion of resources and attention towards compliance, which in some cases, has no measurable impact on customer outcomes.

4. IT system functionality and compliance costs

4.1 The complexity required of banking systems to enable compliance with variation disclosure (and other CCCFA requirements) cannot be overstated. What might appear to be simple disclosures on paper can be very difficult to comply with accurately in practice. The disclosures are so complex that automation in some form is required for all but the smallest lenders. Sometimes expensive upgrades to IT systems will enable compliance (until the next amendment to the regulations). Sometimes banking systems (even if upgraded) still have limitations that make compliance difficult. Lenders with large compliance budgets clearly have an advantage in this regard and CCCFA compliance costs are undoubtedly hurting competition.

4.2 The NBDTs believe that investment in lending technology has been disincentivised due to over-regulation and frequent changes to legislation and regulation fatigue is negatively impacting New Zealand's banking and NBDT sectors. While the NBDTs agree that IT systems should be upgraded to meet regulatory requirements, those regulatory requirements need to be clear, concise and reasonable (and not subject to frequent change). It should be acknowledged that upgrading IT is time and labour intensive, extremely expensive and creates its own risks, uncertainties and disruption, disproportionately so for smaller lenders as they have a smaller customer base over which to spread those very significant costs and a leaner compliance function to weather the disruption. None of that is good for competition, innovation and consumers.

4.3 Increased compliance costs for NBDTs which are mutuals also means negative impacts for the NBDT's members (who are themselves consumers of the NBDT's services). However, the financial impacts of compliance costs extend well beyond the NBDTs and their members. NBDTs have a history of contributing proportionately large sums to the communities they serve (e.g. in the form of grants and sponsorship etc). Increased compliance and remediation costs means that less can be contributed to those groups, which negatively impacts the wider community in very tangible ways.

5. Correcting errors

5.1 The concept of "corrective disclosure" comes from section 99(1) and sections 99(1A) and (1B) which provide that a lender is not entitled to enforce the contract or recover any cost of borrowing for any period during which agreed variation disclosure was required, "*before that* *disclosure is made*". However, there is no statutory provision for the form or content of that corrective disclosure and no substantive guidance from the Commerce Commission. Given the obvious consequences of not undertaking satisfactory corrective disclosure, the lack of direction makes correction of errors more complex and uncertain. One interpretation of what may be required of corrective disclosure according to the wording of s99, is that it requires the agreed variation disclosure which should have been given at the time the variation occurred (as per s22). This would appear to include the change and the effects of the change (according to the Commission's view).

5.2 That being the case, corrective disclosure as a concept appears to be flawed. If the purpose of agreed variation disclosure is to facilitate customers to make informed decisions about their lending in most cases before the change occurs (the NBDTs doubt whether that purpose is even achieved, as discussed above), the NBDTs query what purpose late disclosure of a change and its effects serves, particularly where the error(s) occurred several years ago (as is often the case). As is often the case where corrective disclosure is required, the error may relate to multiple variation disclosures on a contract which occurred over a significant period of time. Disclosure of changes that have occurred on a loan months or years ago, and their effects on the loan at the time the change was made, is sometimes impossible to achieve due to data/system constraints. More importantly, in most cases, it will be entirely redundant and likely misleading and confusing information to the customer. The current position of the customer's loan is far more relevant than what it looked like and what effects a change had at some prior point in time and arguably, aligns better with the purpose and intent of agreed variation disclosure. Uncertainty for lenders over whether corrective disclosure has been adequately performed is not satisfactory.

5.3 If corrective disclosure is to be retained as a concept, it needs to be practical, useful and its requirements clearly articulated. The NBDTs suggest that a better approach would be for lenders to simply notify customers of the error, provide updated loan information if it is not otherwise continuously available through internet banking, and invite customers to seek further information about their loan, if required, under the request disclosure provisions.

6. *Inconsistent remediation*

6.1 There is inconsistency in the approach to remediation amounts. A search of the Commission's case register for enforcement action involving section 22 or relevant parts of section 9C demonstrate that even sophisticated lenders (in fact all the big banks) have, on occasion, struggled to comply with the requirements, sometimes with serious consequences, resulting in varied remediation sums. While this could indicate an unwilling or complacent industry, in the NBDTs' experience, that is simply not the case. To the contrary, it illustrates that despite best efforts and intentions, including sometimes overly conservative approaches to compliance as acknowledged by MBIE in the discussion document, and very significant compliance expenditure by most lenders, lenders are still inadvertently breaching the requirements (sometimes in quite minor or immaterial ways). Further, the consequences for doing so are often significant and inconsistent which leads to uncertainty and greater expense for lenders.

7. *Penalties*

7.1 The application of s99(1A) to a breach of agreed variation disclosure requirements is, in the NBDTs' view, disproportionate. Almost universally customers will have suffered no (or little) harm as a result of a disclosure failure. Section 99(1A) was apparently introduced to ensure lenders do not profit from borrowing decisions. However, the penalty for simply failing to disclose, in relation to mortgages, for example, could be 10 times the profit made on that mortgage. The financial penalty is therefore materially more severe than the financial penalty for price fixing (for example), which is three times the gain made from the breach (capped at $1m for an individual and $5m in any other case). In fact, a breach of any of the significant civil liability provisions in the FMCA (which includes large parts of Parts 2 to 7 of that Act) carry that same maximum penalty.

7.2 There is no plausible requirement for a penalty as severe as the cost of borrowing penalty in the case of variation disclosure – it is completely out of step with all other penalties in New Zealand legislation. As drafted, section s99(1A) has the potential to cause existential risk to a lender (particularly smaller lenders). That should not have been allowed to occur and is why the NBDTs advocate for removal of s99(1A), with retrospective effect.