

SUBMISSION ON THE CREDIT CONTRACTS AND CONSUMER FINANCE AMENDMENT REGULATIONS 2020 EXPOSURE DRAFT

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We are available to provide further consultation as required

Executive Summary

Christians Against Poverty (CAP) supports the majority of the proposed regulations in the draft exposure and believes that these are generally supportive of the intention of the Credit Contracts Legislation Amendment Bill to reduce irresponsible lending and resulting consumer harm.

We are most pleased to see the inclusion of **minimum inquiries and verification steps to assess affordability**. Undeniably, poor affordability assessment has been a significant factor in hundreds of unaffordable loans approved to CAP clients.

CAP sees the impact of unrealistically high loan repayments on client's lives, particularly those on a benefit or on a low income, and it's very damaging:

- Families cannot afford to save any money or to accumulate wealth;
- Families sacrifice essential living costs to repay loans – 67% of CAP clients skipped meals, often regularly, to make loan repayments.
- Families must rely on Work & Income, social services, church charity and food grants for the shortfall – 80% of CAP clients with children struggled to provide food or clothes for their kids;
- Families take out further loans to meet unexpected costs – car repairs, funerals, urgent travel, unexpected sick leave – Over 90% of clients with high-cost debt are in utilities arrears.

CAP also sees evidence of poor affordability assessment **across the spectrum of loan products** with people falling into default and debt spirals in a variety of situations.

- 90% of clients owe money for a bank product – an overdraft, personal loan or credit card;
- 20% of clients have consumer finance debt only owing to banks;
- Over 40% of clients have a credit contract for a non-bank personal loan;
- Over 50% of clients have taken out a credit contract specifically for a car loan.

It is simply not the case that high-cost loans are causing the most harm. Many CAP clients are drowning with bank debt, mainstream personal loans and **particularly vehicle loans**.

In Appendix 1, we attach a case study on this same issue, “Inadequate Affordability Assessments: Three Case Studies”, using information provided directly from three well-known lenders.

In Appendix 2, we have attached a number of examples of client situations where we suspect that there is problematic affordability assessment. **We request that MBIE does not publish this appendix.** While we have endeavoured to remove identifying client data, lenders names do appear. It is not CAP's intention that lender's names be identified within public documents.

In Appendix 3, we provide a list of standard reasonable living expenses that would be common to any budget preparation. We submit that these costs should also be standard during an affordability assessment.

Thank you for the opportunity to provide feedback to these regulations. We look forward to their implementation to provide the protection to vulnerable borrowers that is desperately needed.

*He aha te mea nui o te ao
He tangata, he tangata, he tangata*

Assessment of Suitability

CAP is generally supportive of the proposed new regulations 4AA and 4AB to prescribe the steps to be taken to satisfy the requirements of suitability assessment.

CAP is particularly concerned about the common practice of including waivers, warranties and insurances into car financing arrangements. In Appendix 2, I have attached an example of a quote from a well-known lender that adds \$1,840 of fees and waivers and insurances.

We do have serious reservations about how vulnerable borrowers can be exploited at the point of loan signing to accepting a raft of additional charges, insurances and add-ons. There has often been significant investment of time and energy to get to the point of signing a contract and the addition of different fees, (some mandatory), and waivers, (some optional) could be confusing.

For this reason, CAP recommends the following improvements to the regulations which will assist the borrower to have the information necessary to adequately determine whether additional goods and services meet their requirements and objectives, and to give the lender confidence that purchased additional goods and services have been appropriately considered by the borrower.

Make clear those costs that are optional and those that are mandatory

Lenders should ensure there is a clear distinction between fees that are compulsory and a necessary component of the finance, and those that are indeed optional. In the example provided, there is no distinction between those that are optional and those that are compulsory, so a customer could potentially mistakenly believe that all of the charges are a necessary part of the finance.

Ensure total costs of additional goods and services are clarified

CAP believes that borrowers could be provided further information to make an informed decision of the costs of any additional goods and services by requiring the total costs of the additional goods and services over the life of the loan at the financed rate to be displayed. In the example provided, a borrower may be forgiven for thinking that the cost of mechanical breakdown insurance is \$1,095, but it is rather that amount financed at 21.95% interest over four years (for a three-year product).

If 4AA(2)(e) were adapted to require lenders to include the full costs and to clarify which are compulsory and which are optional, consumers could make more informed choices and may be more willing to seek a more competitive quote from the marketplace.

Clarify that insurance/mechanical warranties already exist under the CGA

We are also concerned about the sale of warranties that may gloss over the rights that borrowers already have under the Consumer Guarantees Act. In relation to the sale of mechanical and breakdown insurances, CAP would like to see clarification that these types of optional insurances are *in addition to protections already provided* under the CGA.

Clarify duration/expiry dates of loan add-ons

In the example provided, some of the waivers are presumably intended to be applicable for the life of the loan, whereas the 'Mechanical Breakdown Insurance 36' is only for three years. We have seen examples of insurances only being valid for year, even though the cost of this one year is financed over the life of the loan. CAP believes that borrowers will have a clearer picture of the proposed arrangement if the duration/lifetime of the additional goods and services is clarified.

Clarify cross-applicability of different loan add-ons

Some waivers and insurances are cross-applicable to each other. For example, a 'restart waiver' that is intended to be valid for the life of the loan, becomes invalid if full insurance (as required under the loan) isn't in place, which may only be provided for one year. This is particularly important for car loans where the different waivers and insurances are often for larger amounts, and the risk to the well-being of the borrower of having waivers and insurances invalidated is higher. It should be made explicit if any waivers/insurances are invalidated by the absence of another. This will help ensure borrowers have the full information about which insurances are important in conjunction with others.

Car Immobilisers are not a good or service for the customer's benefit

CAP would like to highlight the distressing practice of installing immobilisers in vehicles. Some CAP clients have reported that, if they have missed loan repayments, their car has been immobilised by the lender. This has happened when our clients are at the supermarket. It has happened when they have just picked up their child from daycare. It is a humiliating experience. Clients are afraid to fall behind in car repayments and will sacrifice more important essential living costs or will take out further loans to rectify the immediate problem of having their car immobilised.

It is particularly punitive, given that the interest rate that is being charged is intended to compensate the lender for the inevitable cost of some defaults on their books.

Further, clients often **pay for the installation** of this unit and then **pay a monthly 'rental fee'**, financed at the annual interest rate, even though having this unit installed provides no benefit to the borrower, rather only protecting the security interest and repayments for the benefit of the lender.

CAP believes that the costs of any good or service that is not providing an expressed benefit to the client should be prohibited as an additional good or service. If it is a mandatory cost associated with the car loan, then it should be advertised alongside establishment fees so that these fees are disclosed before the time of loan signing.

In the example provided, this immobiliser is listed as a 'telemetric' rental which may not be sufficient description to describe what the unit is and what data and information is being collected.

Assessment of Affordability

CAP is generally supportive of the proposed new regulations 4AC to 4AI to prescribe steps lenders should take to satisfy the requirements of affordability assessment. As written, these proposed new regulations will reduce the damage that is currently being done by the lending industry where loans are approved that cannot realistically be expected to be repaid without substantial hardship.

From our perspective, the serious inadequacy of fair and reasonable affordability assessment **across different loan products and different lenders** has led to harm to consumers.

The process CAP commonly sees

Every day, CAP encounters examples of loans where lenders have not conducted fair and reasonable affordability assessments. When large or unexpected expenses arise, families don't have an ability to pay for them. Families are often forced to go without, or worse, seek out new loans.

Lenders often fail to provide for essential living costs or existing obligations:

- Food and clothing costs are often under-estimated, especially for large families.
- No future expenses. Lenders may allow for petrol but not for WoF/Rego or maintenance.
- No savings for unexpected future needs or for retirement.
- Defaulted debts, court fines, utility arrears and rent arrears are ignored or not asked about.

Appendix 1 – Inadequate Affordability Assessments: Three Case Studies

We have attached three case studies of the affordability assessment conducted for three very different loan products from well-known, established lenders in Appendix 1. Each of these lenders has thousands of clients. CAP and debt counselling services like us are picking up the pieces within families broken by unpayable debt.

Appendix 2 – Examples of CAP budgets for clients

We have also attached a number of budgets that CAP has prepared for clients. While lenders have not provided us with details of the affordability assessment conducted, we are very confident that their long-term financial situation has not significantly changed, nor the members of their household. We often see a client's situation and are genuinely perplexed as to how a lender could have reasonably assessed their situation as affordable.

These assessments are also unfortunately not isolated but are, rather, examples of systematic practice across different loan products and lenders. CAP believes that **a fair and reasonable affordability assessment should be completed for each type of loan product and lender** and that there shouldn't be any loan products or lenders exempt from this expectation.

Appendix 3 – Standard List of Reasonable Living Expenses

This is a standard list of reasonable living expenses that all families must consider when budgeting. This specific list is taken from the www.sorted.org.nz website but is a list of expenses that are common to any financial mentor preparing a budget. Families that aren't provided allowances for

these expenses within an affordability assessment must start taking from other allowances when they don't have enough money, which is where the start of debt spirals always begins.

Affordability Assessment is distinct and separate from Credit Risk

CAP whole-heartedly agrees with the assessment of the UK's Financial Conduct Authority¹:

"1.7 Creditworthiness comprises credit risk (to the firm) and affordability (for the borrower). Most firms have a strong commercial incentive to assess credit risk, including the probability of default, but may have less incentive to assess the risk that the credit will impact negatively on the customer's wider financial situation in particular where these customers will still be profitable for the firm."

It is our experience that lenders all too frequently rely on a credit assessment as a proxy for affordability assessment. In our engagement with creditors we often hear similar themes emerging when we query how affordability has been assessed:

- They have a good credit score and no current defaults;
- We took a copy of their bank statement and their income is stable;
- They've been good customers in the past and their account is up to date;

Unfortunately, bank statements and credit reports just aren't adequate to uncover any difficulties that a customer is facing. As Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA explained in his speech to the Credit Summit in London²,

"Just because the credit performance is good on certain kinds of debts, doesn't mean there aren't problems elsewhere in the customer's cocktail of debts."

Similar to existing responsible lending guidelines

CAP argues that the current regulations as drafted are, as intended, a natural extension of the Responsible Lending Code, and that the process and costs associated with comparing the 'initial estimate of expenses' against a 'reasonable level of expenses' is a fundamental element of what responsible lending actually looks like in practice, particularly in light of the repealing of Section 9C(7) of the Act, which was being used as a scapegoat by some lenders as all the permission necessary to conduct no further inquiries.

The FCA similarly concluded³, when considering the necessity of a cost-benefit analysis, that:

"2.72 We indicated that, where a firm is not currently conducting adequate assessments of creditworthiness, including affordability, it may need to make changes. However, the appropriate baseline for a CBA of any new rules is compliance with the current rules. We

¹ *Assessing creditworthiness in consumer credit*. Policy statement PS18/19. FCA, July 2018.

² <https://www.fca.org.uk/news/speeches/getting-affordability-right-consumer-credit>

³ *Assessing creditworthiness in consumer credit*. Policy statement PS18/19. FCA, July 2018.

can therefore disregard any costs for CBA purposes where any changes merely bring the firm into compliance with the current regulatory regime.”

“2.74 We concluded that any increase in costs for firms would be limited to those needed to bring the firm into compliance with the current regulatory regime, or of only minimal significance, so no CBA was needed.”

It is CAP’s belief that lenders that are already complying with responsible lending guidelines should not incur any significant increase in cost or require any fundamental overhaul in their processes.

A fairer approach – a public standard for reasonable levels of expenses

Regardless of the type of credit a consumer is applying for, an affordability assessment should yield similar results. The fair and reasonable living expenses for a solo mum with three dependents should be approximately the same, whether she is applying for a credit card or a personal loan from a mainstream finance company.

CAP encourages the development of a database of normal household average spends for different demographic situations so that lenders can rely on a public and ‘pre-approved’ reasonable level of expenses, as required by Step 3 in the Exposure Draft Commentary. In the UK, the Office for National Statistics provides information for average family spending. We already have similar information available from the Household Economic Survey and from studies such as the Otago Food Study to provide fair guidelines.

Having established guidelines for industry to draw on will help ensure there is a level compliance playing field so that competition remains focussed on consumer experience and service delivery. The yielded results from a reasonable level of expenses should not be a matter for intellectual property protection, rather a common-sense outcome based on publicly available information.

‘Lower-risk’ loans

It may be argued by industry representatives that they should be provided some discretion to ‘scale back’ the level of inquiries required in situations where it is ‘obvious’ that credit is affordable, but CAP would point out that we have clients that have fallen into hardship **across the spectrum of loan products**.

It is simply not the case that high-cost loans are causing the most harm. Many CAP clients are drowning with bank debt, mainstream personal loans and **particularly vehicle loans**.

CAP sees evidence of poor affordability assessment with people falling into default and debt spirals in a variety of situations.

- 95% of CAP clients owe money for a credit contract or consumer finance;
- 90% of clients owe money for a bank product – an overdraft, personal loan or credit card;
- 20% of clients have consumer finance debt only owing to banks;
- Over 40% of clients have a credit contract for a non-bank personal loan;
- Over 50% of clients have taken out a credit contract specifically for a car loan.

CAP suggests that lenders that are compliant with existing responsible lending guidelines should not be concerned about significant additional time, cost or intrusiveness as a publicly available standard of reasonable living expenses could ensure “Step 3” of the affordability assessment diagram in the Exposure Draft Commentary is completed first, without any unnecessary personal questions being asked unnecessarily.

- To clarify, Step 1 should be undertaken as is written.
- Sufficient demographic information (as suggested in 4AH(3)) could immediately determine whether a reasonable level of expenses still allows sufficient surplus income to proceed with the loan application.
- Applications that satisfy Steps 1 & 3 can proceed to obtaining a borrower’s specific personal expenses.

Essential and discretionary expenses

In CAP’s experience, there are a wide range of everyday expenses that we have heard lenders justify as discretionary, so we are pleased to see 4AD specifically categorise different expenses. The small range of living expenses as categorised in 4AD(b) are very often ignored, as is demonstrated in the Case Studies in Appendix 1.

There are a number of costs that we have heard lenders justify as discretionary but really do deserve to be categorised as essential for the well-being of borrowers. These are social inclusion costs: an allowance for children to participate in sports, an allowance for leisure activities or for an occasional holiday.

The Child Poverty Monitor Report 2019⁴ stated that these considerations are reasonable, stating:

*“There are items, opportunities and material conditions that most people agree are essential for children to grow with dignity in their standard of living, and essential for the people who love them to add value to their lives and development. These can include children having suitable clothes and shoes, **leisure activities**, a good bed, means to keep warm, and sufficient food. Essentials also include whānau with children having resources to pay utility bills on time, cope with unexpected demands on household budgets, enjoy **occasional holidays**, and access health services when they are needed. (emphasis added)”*

Government initiatives like www.sorted.org.nz recognise these as normal household expenses, and are easily identified as normal household expenses, as is shown in **Appendix 3**. Lenders that fail to consider these types of costs are more likely to have clients fall into hardship by incurring costs that they haven’t budgeted for and who then remain trapped in permanent hardship. The Child Poverty Monitor Report 2019 arrived at the same conclusion, stating:

“Children and whānau who are restricted from opportunities to have or do a number of these essentials tend to be locked in these circumstances of disadvantage for prolonged periods of time. This is known as an enforced lack, where someone does not have the opportunity to have or do something because of cost. When locked this state of shortage,

⁴ Child Poverty Monitor 2019. Retrieved from <http://nzchildren.co.nz/>.

sometimes whānau go without one essential to provide a higher priority item for their child or they cut back on or delay paying for essentials.”

Reasonable Surplus

With regards to Step 4 of the Affordability Assessment diagram in the Exposure Draft commentary, CAP believes that a reasonable surplus should certainly include the appropriate allowance so that anyone that is not contributing to Kiwisaver would be able to start.

We would caution against the introducing big ‘buffer’ surpluses in place of proper itemised affordability assessments.

A reasonable surplus should also include the repayment of existing overdraft, credit card, arrears balances so that credit balances with safer forms of credit are available. We often see client cases where no allowance has been made to clear overdrafts or credit cards. The lender is, in effect, requiring ongoing bank financing to enable the new loan to take place.

Presumption of substantial hardship

CAP is supportive of the inclusion of 4AI although the same evidence of being in default on any consumer credit contract within the last 90 days should trigger a responsible lender to satisfy themselves that the default has been remedied.

Joint borrowers / guarantors

CAP is concerned by the proposal within the draft regulations to exclude guarantors from prescriptive affordability assessment principles.

We propose that this assessment need not be identical to the assessment undertaken in respect of the borrower but should be sufficient in depth and scope to the potential obligations which might call on the guarantor.

It is our experience that guarantors are often family members that are not always fully aware of their liabilities. This places vulnerable borrowers and their family members at risk. Guarantors have in cases been used as a source of leverage against borrowers who don’t want the obligation to fall on family members that they know can’t afford it, rather than the guarantor being a legitimate security extension for the benefit of both the lender and borrower, when the borrower can realistically not continue to meet their obligations.

Exceptional Circumstances

CAP recommends that the exceptional circumstances for available likely income of 4AE(b)(iii) **explicitly exclude funds drawn from Kiwisaver on grounds of hardship**. We have seen instances where loans have been approved on the basis that a client is applying for a Kiwisaver Hardship Withdrawal.

Initial Estimate of Borrower's Expenses

CAP recommends that it is clarified under 4AG(1)(e), that if a lender has current arrears for financial commitments, that a fair allowance is provided for to allow these to be cleared. We have often seen client cases where a client has an overdraft and there is no allowance for the repayment of this debt or has a credit card debt and there is no allowance other than the minimum repayment amount. This keeps people trapped in debt spirals and prevents them from accumulating a credit balance in these safer forms of credit.

CAP also notes that if a lender notices a special benefit income such as Disability or Child Disability, Temporary Additional Support, Winter Energy Payments, that these funds are explicitly being provided to meet the *additional* costs of some extra-ordinary essential expenses. As such, these incomes should not be relied on or, at the very least, these incomes should be netted off against equally increased allowances in a borrower's expenses.

Adjust Initial estimate of borrower's likely relevant expenses

CAP is generally supportive of new regulation 4AH but we do recommend that within 4AH(3), the age of dependants should be a requirement for consideration as the costs of raising teenagers and pre-schoolers is very different. In multi-generational households, dependants may also include elderly family members or people living with disability. The costs associated with this care should also be considered.

Advertising Standards

CAP is generally supportive of the proposed new regulations 4AJ to 4AN in relation to advertising.

However, CAP notes that the regulations do not mention requirements for high cost lenders to advertise their daily interest rate. This is important because the interest rate cap of 0.8% applies to high cost loans on a daily basis. A requirement for high cost lenders to advertise their daily interest rate in addition to the annual interest rate is important to allow the Commerce Commission, financial mentors and consumers to easily determine whether a high cost loan is within the cap.

It appears that the regulations do not propose any changes requiring lenders to consistently present their information to allow borrowers to make straight-forward comparisons between different lenders and different products. Information about fees and charges is sometimes hard to identify. We suggest that the regulations require a particular standardised format that provide guidelines on minimum font sizes and, in audible advertising, a maximum standard for the speed with which the information is spoken, so that it can be clearly understood.

While we were unable to ascertain exactly which media is covered by the new advertising regulations, for clarity, CAP submits that these regulations should also cover advertising by text message and through lender apps.

Variation Disclosure

CAP is supportive of the proposed regulations.

Provisions about securitisation and covered bond arrangements

No Comment.

Debt collection disclosure

CAP is supportive of the proposed regulations.

CAP also supports efforts to make information about debtors' rights and obligations as clear and easy to understand so that the debtor can make more informed decisions around complaints appeals and queries about the debt collection.

We note that the regulations do not include any rules around how often a debt collector can contact a debtor. We would welcome any introduction by the minister of regulations to protect clients from unnecessary harassment and pressure. The frequency of constant contact made with the debtor (sometimes by robocall, dozens of times a day) can be a great contributor to stress and anxiety.

Other regulations inserted by the bill (to the Credit Contracts and Consumer Finance Regulations 2004)

New Regulations 5A(2), 5A(3), 5A(4) – MoneyTalks, Dispute Resolutions

CAP supports the intentions behind these new regulations requiring the provision of contact details and information for support services for consumers. One of the major barriers for our clients to access help is the lack of awareness of the existence of these services and their right to utilise them. We are hopeful that these new regulations will mean people can access help sooner.

Contact details for support services should be prominently positioned on websites and all electronic and other correspondence and profiled in public-facing offices.

CAP also submitted to the Select Committee that an obligation be placed on financial services providers to ensure that they co-operate with financial mentors and budgeting services in defined ways. This would enable more effective advocacy on behalf of the borrower. CAP has experienced lenders who have deliberately obstructed the flow of information to us as we act on a client's behalf,

making it difficult to exercise the client's legal rights to access their personal information, arrange hardship deferments and/or to make complaints.

Financial Mentors are often the voice for vulnerable people. Defined co-operation would lead to fairer and more effective outcomes for redress and hardship changes.

Commencement Order

CAP is supportive of the dates that the main provisions of the Bill come into force.

Content of the Annual Return

We support the requirement for lenders to report statistical information annually.

This information should also be made publicly available, even if it is in an aggregate form so that researchers, advocates and media understand how the consumer credit sector is operating in New Zealand.

CAP would like to see inclusion of a requirement for lenders to put their policies and procedures that should set out the principal factors to be taken into account in assessing affordability, in the same manner as the UK industry is required by the FCA⁵ in CONC 5.2A.33. These should be periodically reviewed for effectiveness and changes made where necessary, signed off by senior managers of the lending firm.

We would also recommend including information about the ethnicity of borrowers, and the number of clients that have sought and been successfully connected to financial mentors and disputes resolution schemes.

⁵ *Assessing creditworthiness in consumer credit*. Policy statement PS18/19. FCA, July 2018.