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

Our submissions are informed by our role as an independent dispute resolution scheme, which investigates complaints across a broad spectrum of financial advice, services, and products (except banking). In the year ended 30 June 2019, we formally investigated 71 complaints about lenders and handled approximately 3,000 initial complaints and enquiries about lenders.

We set out our submissions below following the numbered sections of the Discussion Paper (DP). We have not answered all the questions in the DP and have limited our submissions to suggested amendments to the draft regulations. Where we have not commented on specific regulations, we generally support their current drafting.

1. DP SECTION 2 – ASSESSMENT OF WHETHER CREDIT OR FINANCE WILL MEET THE BORROWER'S REQUIREMENTS AND OBJECTIVES

1.1. Draft regulation 4AB(2)(a) states:

> "whether the waiver, warranty, or insurance is **useful** for the borrower, which may include inquiries into…" (our emphasis added).

1.2. We suggest the word 'useful' be changed to the word 'suitable'. We consider the word 'useful' is the wrong word to be used in the context of this regulation. Rather, the lender should be considering whether the insurance is **suitable** for the customer. For example, if a credit-related insurance policy is only triggered following a loss of employment, and the customer is a beneficiary, the lender

should be determining that the policy is **unsuitable**, not that the policy is **not useful**.

1.3. We appreciate that lenders cannot stray into the realms of giving financial advice. However, we consider that, where it is plainly obvious that a borrower will not benefit, or will have only limited benefit under a credit-related insurance policy, repayment waiver, or warranty, it does not constitute financial advice when a lender determines that the policy is unsuitable for the borrower.

1.4. Moreover, the Financial Markets Conduct Act 2013 (following the Financial Services Legislation Amendment Act coming into force on 29 June 2020), will include a carve out (schedule 5, section 10), for lenders from giving financial advice when they are carrying out their responsible lending obligations under the Credit Contracts and Consumer Finance Act 2003 (the CCCFA).

2. DP SECTION 3 – ASSESSMENT THAT A BORROWER IS LIKELY TO REPAY WITHOUT SUBSTANTIAL HARDSHIP

Guarantors

2.1. We note that DP paragraph 35 says that there are no draft regulations in relation to lenders' assessments of guarantors' affordability when entering into guarantees. Paragraph 35 further says that setting out requirements on lenders for suitability assessments of guarantors in the draft regulations, would be disproportionate to the level of risk for guarantors.

2.2. We strongly disagree. We have investigated several complaints where guarantors (often the borrower's parent), have been called on as guarantor to pay a loan after the borrower stops paying and absconds. We consider guarantors often carry **more** risk than borrowers, as they often have assets (for example, a home), that can be placed at risk if they were called upon to pay a loan.

2.3. In addition, we consider it will be confusing for lenders if they are to follow the **regulations** in relation to assessing the affordability of **borrowers**, but they then need to look to the Responsible Lending Code (the Code) for guidance about how to assess **guarantors'** affordability. It would be clearer if the process for lenders to follow in assessing the affordability for borrowers **and** guarantors was placed in one document – the regulations.

2.4. In addition, we consider there is a risk that lenders may carry out fewer affordability checks on borrowers, if there are no regulations in relation to assessing guarantors' affordability. Some lenders may rely on the existence of a guarantee as being sufficient to protect their interest in the loan being repaid. If there are less stringent requirements on assessing the affordability of guarantors, it will be easier for lenders to say the guarantor can afford the guarantee. This may encourage some lenders to be less stringent in complying with the regulations in relation to the affordability of borrowers.

2.5. We note there is provision in the CCCFA for regulations to be developed setting out the affordability assessment for guarantors. New section 138(1)(abd) of the CCCFA says:

> "prescribing, for the purposes of section 9C, –
>
> (i) inquiries that must be made **before entering into**, or making a material change to, an agreement, a **guarantee**, or an insurance contract." (Our emphasis added.)

Unforeseen hardship applications – the problem

2.6. We often find in complaints we investigate, that lenders want to 'help' borrowers by granting them hardship relief. However, if the inevitable is being delayed (that is, that the borrower can no longer afford the loan and their situation is unlikely to improve in the foreseeable future), this makes the situation for the borrower worse, because of increased and continuing indebtedness. In these situations, the value of the secured asset (often a vehicle) can also deteriorate.

2.7. We also see cases where a person has taken out a loan before the responsible lending provisions of the CCCFA came into force in June 2015. Often there was no affordability assessment at all when the loan was originally granted or, if there was an assessment, it was not thorough. There is a high likelihood that the loan was never affordable for the borrower.

2.8. When the borrower then falls into unforeseen hardship under the new responsible lending regime, we consider it would be very helpful if the regulations prescribed the affordability assessment the lender must undertake in assessing an unforeseen hardship application. The risk is that the lender simply reduces the borrower's instalment amount, without first assessing the borrower's financial position, but the reduced payment is still unaffordable.

2.9. We consider it important that there is some form of inquiry into the borrower's financial situation at the time they are making an unforeseen hardship application, so that any agreement made between the lender and the borrower is affordable for the borrower. This would ensure that any offer the lender puts forward to the borrower, after assessing the application, is realistic, and will actually alleviate the borrower's hardship.

Unforeseen hardship applications – what should the regulations prescribe?

2.10. The regulations should set out the inquiries lenders must undertake in assessing unforeseen hardship applications. The inquiries should not be as detailed as the suitability inquiries to be undertaken when a loan is first being granted. However, we consider it would be worth setting out in regulations that, in any unforeseen hardship application, the following minimum steps should be undertaken:

a) Borrower to provide proof of the actual event that has caused the unforeseen hardship (for example, loss of employment).

b) Borrower to provide three months' of bank statements.

c) Borrower to provide a statement of financial position, including their expenses and income. It would be very helpful for regulations to include in a schedule, a model financial position form that lenders could send to borrowers to complete.

d) The lender would address any glaring red flags arising from the lender's comparison of the borrower's statement of financial position and the borrower's bank statements.

e) The lender would not need to undertake the 'reasonable person' expenses assessment required under draft regulation 4AH.

f) The lender should then be required to contact the borrower three months following the granting of the hardship relief. If the borrower's financial circumstances have not changed (for example, if they have not regained employment), the lender should discuss with the borrower that it appears the loan is no longer affordable, and what the next steps are. The next step could be that the loan's security item should be voluntarily surrendered and sold, and the sale proceeds applied to the loan balance (which would then freeze the loan balance).

Unforeseen hardship applications – regulation making power

2.11. We consider that CCCFA section 138(1)(abd) provides a regulation making power in relation to setting out the process for unforeseen hardship applications. Section 138(1)(abd) says:

> "prescribing, for the purposes of section 9C, –
>
> …
>
> (ii) processes, practices, and procedures that a lender should follow when making reasonable **inquiries**." (Our emphasis added).

2.12. We consider that the inclusion of the word 'inquiries' encompasses the inquiries the lender undertakes in an unforeseen hardship application.

2.13. To unpack this a little further, we have first considered paragraph 12.10 of the Responsible Lending Code (the Code), which states that:

> "When a lender is considering a proposed repayment plan as part of an unforeseen hardship application, the lender should have regard to:
>
> a) the likely duration of the unforeseen hardship and what steps, if any, the borrower is taking to address it;
>
> b) the borrower's credit history and any of the other matters relevant to an assessment of whether the borrower can make repayments without substantial hardship;
>
> c) whether the repayment plan will allow the borrower to meet its obligations during the period of the proposed repayment plan and over the remaining life of the credit agreement; and
>
> d) whether the repayment plan would fail to enable the borrower to meet their obligations during the period of unforeseen hardship, would unnecessarily prolong the period of difficulty, or would be likely to result in the borrower experiencing financial difficulties over the remaining life of the credit agreement."

2.14. Paragraph 12.10's guidance essentially sets out the inquiries lenders should undertake in assessing an unforeseen hardship application.

2.15. In addition, paragraph 12.10(b) specifically refers to the 'other matters relevant to an assessment of whether the borrower can make repayments without substantial hardship'. That is, there is a reference in paragraph 12.10(b) to the

'inquiry' lenders need to undertake under CCCFA section 9C(3)(a)(ii), as being potentially relevant to an unforeseen hardship inquiry.

2.16. In addition, the eventual repeal of CCCFA section 9C(7) means that lenders cannot rely on information provided by the borrower in their inquiries under section 9C(3)(a)(ii). It follows that lenders should not be able to rely on information provided by borrowers in the inquiries they undertake for unforeseen hardship applications, because the two inquiries are inextricably linked. It would therefore be beneficial for the regulations to set out the process for lenders to follow in unforeseen hardship applications.

Reasonable surplus

2.17. With reference to DP paragraphs 40 and 41, we agree with the inclusion of the reasonable surplus requirement in draft regulation 4AE(b)(i). A borrower's budget should not be so tight that they have no 'rainy day fund'.

Regulation 4AH – estimated versus 'reasonable' expenses

2.18. Regulation 4AH states that once the lender has assessed the borrower's estimated expenses under regulation 4AG, the lender must then compare the borrower's estimated expenses against the **reasonable** expenses that a person in the borrower's situation would have.

2.19. However, where are lenders to obtain the details of a 'reasonable person's expenses'? For larger lenders, an analysis of statistics within their own customer base would probably provide the data needed. However, for smaller lenders, there is no guidance about where they can obtain data about average expenses for different groups of people in society.

2.20. We consider it would be helpful for the regulations to refer lenders to where they could obtain this data. MBIE may want to consider whether it could produce a document based on information from Statistics New Zealand about its Household Expenditure Statistics (HES). More information can be found here: https://www.stats.govt.nz/information-releases/household-expenditure-statistics-year-ended-june-2016-nz-stat-tables

2.21. Whatever information is supplied, it should be regularly updated.

Draft regulation 4AF(1)(b)

2.22. We consider draft regulation 4AF(1)(b) could be strengthened by including a reference to a period of **3 months'** of **income** records. There is a 3-month period for verification of **expenses** (see regulation 4AG(1)(b)).

2.23. We make our submission because borrowers often have fluctuating incomes, especially if they are self-employed or seasonal workers. Making it clear that lenders must obtain income verification for the previous 3 months, would ensure that lenders have more accurate information about a borrower's income.

Draft regulation 4AE(b)

2.24. This draft regulation is poorly worded and contains a double negative. We suggest it should read:

> "be satisfied on reasonable grounds that it is likely the borrower will meet the payments under the agreement without suffering substantial hardship because –".

3. DP SECTION 5 – VARIATION DISCLOSURE

3.1. With reference to DP paragraph 90, we agree that variation disclosure should disclose the **effect** of the change. However, we consider draft regulation 4F does not actually meet the policy intent.

3.2. We consider that variation disclosure needs to directly compare the current credit contract's wording, and the proposed variation wording. For example, if there has been an agreement to make a further advance under the credit contract, the variation disclosure would need to clearly show:

a) The amount of the unpaid balance before the variation, compared with the amount of the unpaid balance after the variation.

b) The instalment amount prior to, and after, the variation.

c) The total interest and fees payable over the life of the loan (if ascertainable) prior to the variation, and after the variation.

d) The total amount payable under the loan (if ascertainable), prior to the variation, and after the variation.

3.3. The consumer should not need to compare the original disclosure information they would have received under CCCFA Schedule 1 (which may have been provided years earlier), with the information they receive under variation disclosure. Without the lender outlining a true comparison, the purpose of variation disclosure would not be achieved. That is, that the borrower can make an informed decision about whether to vary the credit contract.

4. DP SECTION 7 – DISCLOSURE BEFORE DEBT COLLECTION STARTS

4.1. We consider that draft regulation 24(1)(g) should refer to the borrower/debtor's ability to complain to the lender's dispute resolution scheme (DRS) if an unforeseen hardship application is declined (discussed further below, in section 5).

5. DP SECTION 8 – OTHER REGULATIONS INSERTED BY THE AMENDMENT ACT

Regulations made by the CCCFA

5.1. Section 69 of the Credit Contracts Legislation Amendment Act (the Amendment Act) amends the Credit Contracts and Consumer Finance Regulations 2004 (the 2004 regulations), by way of inserting new regulations directly into the 2004 regulations (the Amendment Act Regulations). The DP calls for submissions on the Amendment Act Regulations at the same time as submissions on the draft 2020 regulations.

5.2. We suggest an amendment to regulation 5A of the Amendment Act Regulations, which we discuss in the following paragraphs.

FSCL's June 2019 submissions on the Credit Contracts Legislation Amendment Bill (the Bill)

5.3. In our June 2019 submissions on the Bill, we submitted that CCCFA section 58 should be amended to state the lender should be required to tell the consumer they can either approach the court **or the relevant DRS**, if they have a complaint about the unforeseen hardship application process, or the outcome of their application.

5.4. We further highlighted that the DRSs are specifically designed to investigate these types of complaints. Approaching court is not an option for most consumers, because of the cost and time involved at a time when they are

already under financial pressure. We said the current section 58 effectively deters consumers from seeking redress through a DRS.

5.5. MBIE's Departmental Report on the Bill identified our submission and outlined the policy response to the submission as:

> "**Agree**. We recommend that section 57A of the Act be amended to require the creditor, in their mandatory acknowledgement of hardship applications under section 57A(1)(a), to advise the consumer that:
>
> - they can approach a dispute resolution scheme or the court if they have a complaint or concern about their application or its outcome, and
> - provide the contact details for a financial mentoring service." (Our emphasis added.)

5.6. MBIE agreed with our submission. However, it then suggested an amendment to section 57A(1)(a), which in turn refers to amended section 26B(1)(a) and (2)(b)) of the Amendment Act (instead of simply amending CCCFA section 58).

The problem

5.7. We do not think it is enough that borrowers are advised, **at the time they first make their unforeseen hardship application**, that they can complain to the lender's DRS if they do not agree with the lender's decision on their application. Highlighting that the borrower can contact the DRS about a declined hardship application is most effective if the borrower is advised of this avenue, **at the time the lender makes the final decision on the hardship application**.

5.8. We submit that the policy intent was that borrowers should be advised by lenders about the ability to complain to the lender's DRS if the borrower does not agree with the outcome of their unforeseen hardship application. However, this policy intent has not been reflected in the Amendment Act, or the Amendment Act Regulations.

Our proposed solution to the problem

5.9. CCCFA sections 57A(1)(a), 26B(1)(a), and 58 cannot now be amended. However, new regulation 5A (inserted by section 69 of the Amendment Act), can be amended at the same time as the 2020 draft regulations are being consulted on.

5.10. Arguably, draft regulation 5A(2) states that the information about the DRS needs to be provided when the customer makes a complaint. And, the borrower will be making a 'complaint' (expression of dissatisfaction), if they tell

the lender they are not happy with the outcome of an unforeseen hardship application.

5.11. However, if a borrower receives a CCCFA section 58 notice saying that the borrower can contact a **court** if they do not accept the outcome of the unforeseen hardship application, they may never contact the lender, and the lender may not be aware the customer has a complaint. In turn, the borrower may never be referred to, or be aware, that they could contact the DRS.

5.12. We therefore consider it imperative that the lender tells the borrower about the ability to contact the DRS at the time they are issuing their decision on an unforeseen hardship application (whether the application is accepted in whole or in part, or fully declined). We suggest an amendment to draft regulation 5A.

Mechanism to amend regulation 5A

5.13. Regulation 5A is stated as being 'for the purposes of section 26B of the Act'. Section 26B is headed: "**Disclosure about dispute resolution schemes** and financial mentoring services: **hardship applications,** arrears, credit declined, and complaints." That is, regulation 5A relates **in general** to disclosure about DRSs in relation to hardship applications. The disclosure does not need to be linked back to there being a 'complaint'. Moreover, new CCCFA section 138(1)(dba), says that regulations can be prescribed for the purposes of section 26B (as a whole), in terms of **when** information about the DRS needs to be provided.

5.14. We therefore consider there is scope to amend the wording of regulation 5A. We suggest regulation 5A could include a further sub-regulation, regulation 5A(2)A, with wording akin to:

> "For the purposes of disclosure about dispute resolution schemes in relation to hardship applications, lenders must disclose (in a notice issued under CCCFA section 58) that borrowers have the ability to contact the lender's dispute resolution scheme, if they do not accept the lender's decision on their unforeseen hardship application.

Thank you for the opportunity to provide submissions on the draft regulations. If you have any questions, or want to discuss our submissions in more detail, please contact us.

Yours sincerely

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