Exposure draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020

Commentary and submission from Credit Union Auckland Incorporated (t/a NZCU Auckland)

Introduction

The introduction states that the Credit Contracts and Consumer Finance Act 2003 (**the Act**) helps to protect consumers when they borrow money. In April 2019, the Minister of Commerce and Consumer Affairs introduced the Credit Contracts Legislation Amendment Bill. The purpose of the Bill was to reduce irresponsible and predatory lending and resulting consumer harm.

The Bill provided for the creation of regulations to support the new requirements and some of these new regulations were provided in an exposure draft of the Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2020 (**the draft regulations**) issued in November 2019. Feedback has been requested on the draft regulations, the commencement order, additional regulations inserted by the Bill and initial policy thinking on the content of the annual return.

NZCU Auckland wishes to make submissions on these points and contribute to further discussions on the matters.

Submission

In order to create a fair and equitable regime, the coverage of the draft regulations should be widened to include credit issuers who are currently advantaged by the fact that legislation has not kept pace with technology. For example, "buy now pay later" entities and their offerings sit outside the Financial Services Providers Register which gives them an unfair advantage in the market. These entities are currently not deemed to be "providers of financial services" and are not required to be registered under the Financial Services Providers (Registration and Dispute Resolution) Act 2008. The claim is that they merely provide a "payment channel" and do not provide finance. This means that they are not subject to any jurisdiction in terms of oversight and compliance with a code of practice.

This is a scenario that cannot be allowed to continue. The basis of their service is that a consumer purchases an item or service, takes delivery of that item or uses that service and pays the agreed price over a set number of instalments. If these instalments are paid on time, no further charge is made to the consumer. If any instalment is missed, fees are incurred. How is this not a loan and how is it different from interest free offerings from various finance companies or a credit card purchase?

The development and expansion of digital platforms and processes are moving faster than legislation has kept up but the protection of the consumer and maintenance of a level playing field for participants in the financial services industry must be the guidelines for legislation and regulation. Although their inclusion may require a further legislative change, it is imperative that it happens quickly.

Assessment of whether credit or finance will meet the borrower's requirements and objectives

KEY AREAS WE WOULD LIKE YOUR FEEDBACK ON:
- The proposed process for assessing the borrower's requirements and objectives.
- How these regulations could be refined to minimise cost for lenders.
- Other features of an agreement that lenders should ask borrowers about.

Submission

Knowing the stated purpose of any loan request is vital in all circumstances. Such purposes must be legal, valid and appropriate to the circumstances of the applicant. For example, financing high risk ventures or purchasing luxury items when the applicant appears to be struggling day to day should be contrary to the spirit and intent of the regulations. While this may seem over-prescriptive, such purposes are often promoted and sold to those most vulnerable (and least able to critically assess the offer) in our communities.

Assessing the borrower's requirements and objectives should extend beyond the initial consideration and approval of the loan request. Section 4AA(i) applies only to the process "before" the lender enters into an arrangement. The obligations on the lender should extend to post-completion of the loan process. The additional obligation should be inserted to require confirmation that any loan proceeds disbursed on behalf of the borrower has been used for the stated purpose. In many circumstances, this is vital to protect all parties. For example, where the purpose of the loan is debt consolidation (and especially where the borrower is currently over extended and is seeking relief in terms of either reduced interest/payments or extended period) it has significant negative impact on the borrower's future circumstances if the proceeds of the new loan is not used for the intended purpose (that is, repayment of the existing debts). If this does not happen and the new loan proceeds are used for other purposes, the new loan repayment becomes an additional burden rather than a relief.

The current practice of many banks and other financial instructions is merely to deposit the bulk (if not all) of the loan proceeds in a bank account under the control of the borrower without any verification of its use in terms of the stated purpose. An amendment to the draft regulations could be made to require lenders to pay appropriate proceeds of the loan to the creditors (in the case of a debt consolidation loan) or the vendors of the asset where the purchase of that asset is the stated purpose.

Assessment that a borrower is likely to repay without substantial hardship

KEY AREAS WE WOULD LIKE YOUR FEEDBACK ON:

- The proposed regulation requiring there to be a reasonable surplus after estimating likely income and expenses.
- Whether there are any other exceptions that are not adequately captured by the provision for exceptional circumstances to the general rule.
- Whether the proposed requirement to compare the initial estimate of expenses against a reasonable level strikes an appropriate balance between prescription and flexibility.
- How much, if any, of the proposed process above should apply to an assessment of affordability for guarantors.
- How these regulations could be refined to better reflect existing good practice and minimise cost for lenders.

Submission

Section 32 of the nature and scope of requirements sets out an explanation as to why the "comply or explain" approach is not viable in these circumstances. We cannot agree that this should be eliminated in all circumstances. The situation that many Credit Unions Members find themselves in is that they are often faced with cultural or family expectations that they feel they must fulfil or lose "face" or standing in that community or family. They rely on Credit Unions to assist with this need having proved their loyalty to their Credit Union in the past. While a loan or loan extension may look unaffordable technically, Credit Unions know that the expectation is so high that if the request is declined, the Member will go to a less reputable payday advance lender, pawn broker or high risk lender and pay much higher fees and interest. This will ultimately lead to more extreme financial distress for the borrower.

Section 42 details a diagram depicting the process for assessing affordability. This is excessively prescriptive and requires the examination of records/documents that are often not available, situations that are often not verifiable and data not freely available. For example:

1. The suggestion is that income/expenses can be verified by bank records. Almost every New Zealander has more than one bank relationship and within families, income and expenses are often pooled across a number of facilities. With the high significance the draft regulations place on this process, how can these be identified and inspected with any degree of certainty?
2. The draft regulations would require borrowers to be questioned about cash withdrawals. How can their answers be verified? For a large segment of society "cash is king" as evidenced by our own experiences with Members and the recent RBNZ paper on the future of cash. These borrowers do not keep receipts or other evidence of the cash utilisation;
3. How can raw credit reports identify financial commitments when the only "evidence" may be an enquiry? Comprehensive Credit Reporting would be a useful tool in this regard but is not freely available to all and extremely expensive to implement for smaller lenders;
4. Who determines "a reasonable level of expenses" for a specific size family? Family expenditure will vary from family group to family group and especially within the Pacifica community, "the family" is often a fluid grouping of members who come and go as circumstances and cultural expectations change.

While the nature and intent of the draft regulations is to ensure that borrowings should be affordable, the emphasis of the regulations is on a process that is overly complicated, too prescriptive and takes no account of the size of the proposed loan, any existing relationship between the applicant and the lender and the reality of everyday living for most people of limited (or even average) means.

4AI High-cost consumer credit contracts—Presumption of substantial hardship
This regulation assumes that consumers who use high cost lenders such as payday advance lenders are automatically suffering hardship. This is very often the case. This is exasperated by the marketing undertaken by these lenders who will specially advertise to a market segment that this section is aiming to protect. Their offers of “loans without credit check” or “bad credit loans” or “learner licence loans” entice these very people who are desperate for a loan for whatever purpose but usually for living expenses.

The conundrum of this provision is that the presumption of hardship requirements in the regulation could often mean that credit is denied. Many of these potential borrowers will not/cannot accept this situation and will be driven further down the scale of lenders to those even more unethical or illegal lenders as a last resort.

While it may seem counter-productive not to include the provisions outlined in the draft regulations, the reality is that desperate borrowers will find a way to get the money they need to survive or honour the obligation they believe they have. If the price of this desperation is the continuity of the high risk lenders, then stronger limitations on their interest rates, fees and collection methodologies might be a better way of achieving the desired results.

The wider issue is one of poverty within the community and the limited access to finance options for lower socio-economic communities on terms that they can afford. Other countries have adopted solutions which could provide suitable templates. The Good Shepard micro-finance options available in Australia is an example which has been attempted in New Zealand with the Salvation Army/BNZ as the only provider but with limited funds made available to make it worthwhile. This is an issue that these regulations cannot solve but the Government should address by working collaboratively with reputable charities and “public good entities” such as Credit Unions.

Advertising

KEY AREAS WE WOULD LIKE YOUR FEEDBACK ON:
• How these regulations could be refined to reflect existing good practice and minimise undue cost for lenders

Submission

Section 68 of the explanatory document sets out the limits of the regulations relating to advertising to cover only public or "systematic" advertising. While this is a practical approach, we would also request that any communication with existing Members of a Credit Union or other co-operative is also exempt as it should not be deemed to be "public" but to a limited audience.

New regulations 4AK - 4AN impose very restrictive practices that overall deprive consumers of simple knowledge about the product by requiring complex and detailed additional data to be included. In any situation, when assessing the value of a product or service, consumers want some basic information with which they can make a "face value" assessment of whether or not to investigate further. In other words, they want to make a preliminary assessment in private without having to talk to anyone or multiple people from different providers.

The example in Section 74 of the washing machine is interesting. There is no mandatory requirement in legislation that when advertising the price of washing machines that details of its capacity, electricity use or warranty conditions are shown in the advertisement. While washing machines and loans are different classes of products, the objective of this regulation is consumer protection. If the principle is sound, why isn't it applied to all products? Even where there is a requirement of some explanatory information, there are few instances where this is required to be "least as prominent as the other information provided". The requirements of this section go well beyond what is required even for high risk products such as alcohol where it is permissible to show very little information.

This makes the regulation regarding interest rate advertising cumbersome and impractical.

Many decisions on the final interest rate applicable to a specific loan is determined by the imperative of "rate for risk" which can only be determined after the application has been received and assessed. While the intention is to limit "unrealistic and potentially misleading representations" and we would agree that "bait" advertising is harmful, it would be equally misleading to display a set of conditions that a specific interest rate is applicable to without the consumer understanding whether or not they fit that description. For example, Section 76 refers to a representation of "rates from 9.99%p.a." requiring "a more fulsome description of applicable interest rates and any mandatory fees". Such a description would need to include all the conditions that go towards assessment of a loan application to qualify for that rate to be truthful and reliable. And in the end, a rate may finally be determined by competition not necessarily consistent with stated policy.

Allowing the advertising of a minimum and/or maximum interest rate is not unduly negative and is preferred.

Section 83 refers to other situations such as the advertisement of quick responses. This is not something that can be treated with a blanket negative approach.

There are many factors such as existing knowledge of the applicant or technology that makes the claim realistic and not a negative. Where we have a detailed knowledge of an existing Member, it is not an unusual practice to advise an approval or decline at the time of first approach. We often know so much of the Member's financial and domestic realities that we can make an appropriate and justifiable answer within the sort of time frames referred to in the draft regulation.

Similarly in the case of a new borrower. A review of the application document can immediately point to factors that would preclude acceptance or allow approval subject to the verification of some of the elements.

Certifications of directors and senior managers as fit and proper persons

Submission

Although included in the Amendment Act, this is an unnecessary requirement on lenders who are already licenced by the RBNZ. As Non-bank Deposit Takers (NBDT), Credit Union Boards and senior management are already subject to a "fit and proper person" regime and suitability criteria by the RBNZ including Police Checks.

Before a Director or senior manager of a NBDT can be appointed, they must receive confirmation from the RBNZ that there are no suitability issues with the individual which would cause the RBNZ not to agree to the appointment. MBIE (as part of the registration for the Financial Services Providers Register) also undertake further Police Checks and verifications.

To add this third layer of scrutiny on individuals who in many cases are not "professional" Directors but part of a co-operative, is unwarranted and unnecessary. There are already sufficient checks and balances in place to affirm individuals as "fit and proper" without the need for this regulation.

Given these extensive enquiries and qualifications already required of Directors and senior managers of Credit Unions and NBDT's generally, the application process in the Act should be waived for these entities and the existing processes acknowledged and relied upon.

Submission

This is bureaucratic overreach which will add very little to the Commission's knowledge/oversight of the industry but create high additional compliance costs. The level of detail included in the draft regulations is excessive and would require significant amendments to our systems to comply. Credit Unions, as institutions, are already heavily regulated and compliance controlled, more than most others within the finance industry.

For example, we are already required to submit:

1. Monthly reports to the RBNZ covering our Balance Sheet components which included segmentation of our Loans book, security attached to these Loans and Loans/Value ratios;
2. Annual Returns to the Registrar of Credit Unions;
3. Quarterly financial data updates to the Disclose Register;
4. Annual Returns to MBIE under the Financial Advisers Act including details of any complaints;
5. Annual confirmations to the RBNZ under the AML/CFT Act including transactional data, annual revenue from each product or service offered and the various channels utilised;
6. Annual confirmations to MBIE under the Financial Services Providers (Registration and Dispute Resolution) Act 2008;
7. Annual returns to the RBNZ under the Deposit Takers (Credit Ratings Minimum Threshold) Exemption Notice 2009.

We question the need for such detail as the information to be provided in relation to car finance. What is the purpose of this information? The information regarding insurance coverage and claims is surely better provided by the Insurers themselves rather than the lenders?

Sections 147-159 are such high detail requirements that their imposition could well impact on the financial viability of smaller lenders and co-operatives such as Credit Unions.

The issues around the provision of such detailed information continues the often seen philosophy of "one size fits all". The data is requested regardless of the performance, size and reputation of the lender. The use that this data would be put to is not sufficiently explained and consequently not open for comment. A lot of the data requested involves details of interaction with third parties not the responsibility of actual lender. For example, the insurance details and complaints records which would be more accurately available directly from these independent parties.

In our view, a better approach would be to concentrate activities on those who are identified as rogue elements or consistently failing to meet their obligations or have a track record of disadvantaging consumers. This would allow resources to be better concentrated on high priority defaulters rather than reviewing everyone when only a few are at fault (the 80/20 Rule). This could be achieved by the following process:

1. Assess the performance of lenders through their complaints processes. All registered Financial Services Providers are required to have a dispute resolution service and their records could form the basis of the data sought;
2. Require the dispute resolution services to provide the data outlined in Sections 160-161 which would be much more relevant to the work of the Commission. The details of all complaints received by a lender is not a useful gauge as if the complaint does not reach the registered dispute resolution service it means that they have been resolved to the satisfaction of the borrower. Surely an acceptable outcome;
3. Audit those lenders who have multiple complaints against them in any 12 month period referred to the dispute resolution services. The basis of the audit would be the provision and analysis of the data requests outlined in the draft regulations. This would allow specific lenders to be reviewed through the lens of known consumer dissatisfaction rather than just compliance;
4. Adopt the same methodologies has have been used against the banks in recent years where their systems and processes have failed to protect consumers and they have been required to repay interest/fees previously charged.

Again, the provisions of the draft regulations seem to take the view that all lenders are bad and need to be tightly controlled. There is no acknowledgement in the draft regulations that some lenders have a history and reputation of being consumer focussed and actually provide a valuable and sought after service to their respective communities. Credit Unions fit this description and should be given some recognition for their behaviours over many decades in support of weaker parts of our economy. Legislation and regulations should entrench and reinforce this type of “public benefit” behaviour rather than impose regulatory overreach that potentially limits their ability to continue this service.