5 February 2020

Competition and Consumer Policy team
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
WELLINGTON 6140

Via email: consumer@mbie.govt.nz

Dear Sir/Madam,

Submission on Credit Contracts and Consumer Finance Amendment Regulations 2020 (the *Regulations*)

This submission is on behalf of Save My Bacon Ltd (**SMB**).

As a general comment, we are supportive of the Regulations and the approach taken. We provide below our comments on those aspects that have practical implications or where further guidance and/or clarity would be helpful.

ASSESSMENT OF WHETHER CREDIT OR FINANCE WILL MEET THE BORROWER'S REQUIREMENTS AND OBJECTIVES

1. The primary area of concern for determining loan purpose is the level detail or granularity that is expected of creditors. Regulation 4AA(2)(b) states that a creditor must determine the "purpose of credit or finance". However, it is unclear as to the depth of this requirement. Is the expectation that we list, say, 9 "specific" categories and a 10th catch-all for "other" purposes? Is 10 categories too many or too few? Should we offer sub-categories beneath each major category? What if the loan has a dual purpose and

the applicant intends to use the funds for different purposes? Should the creditor bifurcate the loan and conduct separate determinations for each purpose?

2. The matter is further complicated by the fact that a creditor may come to a different view of the purpose of a loan than the borrower due to the fungibility of money. For instance, a borrower might state a loan is for the payment of utility bills. However, on analysis of the borrower's banking records it becomes clear that the cause of the financial need is the cost of car repairs that were paid for last week. The immediate financial need is to pay utilities, but that is not the reason giving rise to the funding requirement. Which prevails? The borrower's stated purpose or the cause of the financial need? Further, if a creditor determined that the loan purpose was car repairs (and not the payment of utilities) then the complexion of borrower's requirements and objectives changes significantly.

3. It is difficult to see how this issue could be alleviated by amending the wording of the regulation, but it does demonstrate the need for further guidance on these matters to ensure that a creditor is not unduly exposed if its reasonable determination of loan purpose differs from that of the borrower.

ASSESSMENT THAT A BORROWER IS LIKELY TO REPAY WITHOUT SUBSTANTIAL HARDSHIP

Amount of surplus

4. We believe the formulation of the affordability test in regulation 4AE meets the policy objective while still allowing flexibility for creditors to make judgements. We would not support a prescriptive rule regarding the nominal or percentage amount of surplus required as it would be too rigid and allow no flexibility to cater for a borrower's individual circumstances. The inclusion of the words "reasonable inquiries", "reasonable grounds", and "likely" income and relevant expenses are necessary qualifiers to the scope of this provision. Creditors do not have access to complete or perfect information when making inquiries and trade-offs will be needed on a risk and cost v benefit basis when making determinations. It is imperative that creditors have some latitude to make judgements - measured against what is reasonable and likely - when undertaking these assessments (especially now that section 9C(7) has been repealed).

5. We have undertaken some analysis of the surpluses of our borrowers and default rates to seek to understand whether there is any correlation between the amount of the surplus and the likelihood of default. It appears, contrary to our expectations, that borrowers with a lower surplus are less likely to default when compared to those with a higher surplus. We would be happy to share more of our analysis in this regard on a confidential basis outside of the formal "public" submission process, if you believe this information would be helpful.

Relevant expenses

6. We believe the definition of "relevant expenses" in regulation 4AD could lead to confusion and unforeseen outcomes. We prefer the Australian Securities & Investments Commission's (**ASIC's**) formulation that focuses on "essential" and "non-essential" expenses. Only costs that are essential should be considered when assessing affordability. ASIC lists the following expense categories as "essential":

   (a) Housing/rental;

   (b) Food, clothing and personal items;

   (c) Utilities;

   (d) Transport and related costs such as registration and insurance;

   (e) Health, education and childcare; and

   (f) Communications and connectivity.

7. Other "non-essential" expenses, like discretionary expenses, are by definition able to be avoided or modulated by the borrower should the need arise. The inclusion of non-essential or discretionary expenses within "relevant expenses" removes the flexibility for borrowers to:

   (a) make choices about what is important to them; and

   (b) adjust their financial behaviours to meet their current circumstances.

   This flexibility could be the difference between a borrower obtaining finance that is affordable (albeit with some lifestyle impact) or being financially excluded.

Materiality and relevance

8. The interaction between regulations 4AE, 4AF, and 4AG requires clarification. Regulations 4AF and 4AG appear to mandate items that "must" be obtained whereas regulation 4AE is focused on "reasonable inquiries". The requirements of regulation 4AF and 4AG should be subject to a "reasonableness" overlay as required by section 9C(3)(a) and regulation 4AE and this interaction should be made more explicit. A reasonableness requirement enables creditors to apply the concept of materiality and curtail unnecessary evidential inquiries that do not advance the quality of the analysis or change the outcome of a creditor's affordability assessment.

9. This point can be demonstrated in the context of transfers or cash withdrawals. Regulation 4AG(1)(b)(ii) appears to require a creditor to trace (and obtain transaction records) for all and any account into which funds are transferred regardless of the size or relevance of the transfer. However, in many cases, if the transfer was treated as a "relevant expense" the cash surplus of the borrower might be sufficient that no further inquiry is warranted and further tracing yields no further insights for the creditor. Some constraints or limits should be placed on this requirement and making regulations 4AG(1)(b)(ii) and 4AG(1)(c)[1] subject to reasonableness or materiality requirements would achieve this objective.

10. In our experience, transfers that result in a shortfall of funds and subsequently cause the reversal or default on payments provides more insight into the creditworthiness and financial position of a borrower than simply tracing the funds to their destination. That is, transfers and withdrawals behaviour can provide a great deal of insight into the likely future conduct of (or credit risk arising from) a borrower.

11. A further practical issue arises if the transfer is made to a bank account held by a different person or that is not in the name of the borrower, e.g., a family member, flat mate or joint account. Privacy constraints would impede or preclude a creditor from

[1] There is a certain amount of irony in the fact that regulation 4AG(1)(c) requires a creditor to ask the borrower what expense this cash withdrawal might meet, but following the repeal of section 9C(7) a creditor is not able to rely on this information.

obtaining this information without the account owner's consent (that may not be able to be obtained).

12. Similar issues arise for minor or non-recurrent income that - it appears on the plain language of regulation 4AF - must be verified regardless of whether the income is material to the borrower or relevant to the affordability of the loan.

Credit reports

13. The requirement in regulation 4AG(1)(e) to obtain a credit report may not provide the insights implied by this regulation. We find credit reports a useful piece of information, but we are concerned that their insights into a borrower's circumstances might be overstated or even misunderstood. In this regard, it is worth reviewing the content and purpose of credit reports. Fundamentally, a credit report is a credit bureau's opinion on the creditworthiness of a person, i.e., it seeks to provide an opinion as to the probability of a person defaulting on a financial commitment. A credit report does not provide information on "relevant expenses" per se (although it may reveal matters requiring further inquiry).

14. Credit reports are subject to a number of inherent limitations, including:

    (a) A credit report is rarely based on complete information. That is, many creditors and utility providers only report payment information to one credit bureau so that data relied upon by the credit bureau is limited. If a creditor acquires a credit report from another credit bureau, then that other bureau might be aware of the adverse credit history known by the first bureau.

    (b) Not all creditors are part of the comprehensive credit reporting regime such that only negative payment data is reported. This limited (negative) reporting can mean that no data is shared on whether or not a loan was granted and, in the case of default, it may not be reported until well after the default. Comprehensive credit reporting provides better quality data, but unfortunately many creditors (particularly in the high-cost credit market) do not participate in this regime.

(c) Credit reports show creditor inquiries but, unless the creditor participates in the comprehensive credit reporting regime, credit reports do not provide information on whether a loan was granted, whether it has been fully repaid, or is still outstanding. That is, a credit report does not provide a comprehensive view of a person's outstanding loans.

(d) The purpose of credit reports is more directed at determining a borrower's creditworthiness and not affordability. This point is well made and explained by the UK's Financial Conduct Authority (**FCA**) at paragraphs 1.7, 1.18, 1.20 and 1.32 of the FCA's "Assessing Creditworthiness in Consumer Credit" policy statement.[2]

15. This commentary leads to a broader issue for creditors in that there is no full-proof way to determine whether a borrower has undisclosed outstanding loans, i.e., trying to prove the negative (no outstanding loans) is inherently difficult. In this regard, we note the following:

(a) A bank statement review will only show loan repayments where they are actually being made. If payments are not being made, then no payments will be present to reveal the existence of a loan.

(b) Failed direct debit payment attempts will show as reversals on a bank statement, but if a loan is being repaid by way of automatic payment and the borrower cancels the automatic payment, then there will be no record of the payment or required payment.

(c) Credit reports are subject to the limitations noted above and, if a creditor has not lodged a default (or not yet lodged a default) or is not participating in comprehensive credit reporting on a "public" basis, then it will not reveal any outstanding obligations.

(d) Privacy constraints and concerns prevent or impede a creditor from approaching other creditors to request information about a borrower.

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[2] See https://www.fca.org.uk/publication/policy/ps18-19.pdf

(e) No central register of credit obligations is available.

16. A creditor, therefore, is left in a difficult position when it comes to assessing and uncovering the existing financial commitments of a borrower. A centralised register of outstanding credit obligations would greatly assist creditors and would be welcomed by creditors. Separately, but aligned to this point, is the treatment of undrawn overdrafts and/or unused credit card limits. Often these lines of credit are held as a reserve or buffer and may not be drawn or, in the case of credit cards, fully repaid before incurring any finance cost. Further guidance on the treatment of contingent financial commitments would be welcome (although this aspect may be better addressed in the revised Responsible Lending Code or other guidance). The existing practice is generally to allocate an arbitrary percentage of the credit limit as a cost when determining a borrower's "relevant expenses".

Benchmarking

17. We can see some difficulty when attempting to apply regulation 4AH in practice because what constitutes "reasonable cost of expenses" is likely to vary considerably from one borrower to the next. The test, therefore, needs to be applied objectively to the borrower's subjective circumstances and lifestyle choices. Expanding this line of thought further, the definition of "reasonable cost of expenses" in regulation 4AH(3) imports the concept of averages or "normal" expenses for borrowers. However, a normally distributed average by definition means that approximately half of persons will have expenses below average and half above. It is not clear how much scope a creditor has to take into consideration the normal distribution of expenses that could be expected and that would be acceptable when making this assessment. Some borrowers are comfortable (and able) to live far more frugal lifestyles than the average and these persons should not be penalised for their thrift. The subjective assessment of a borrower's circumstances has also been made considerably more difficult with the repeal of section 9C(7) and the inability for a creditors to rely on direct inquiries with the borrower.

Presumption of substantial hardship

18. We would recommend regulation 4AI(3) be modified to allow for the scenario where a borrower misses a payment, but continues to make future payments from the next scheduled date on time. For example, it is common for borrowers to miss payments around holiday periods (e.g., Easter or Christmas), but then revert to paying as scheduled after that payment period as required. The missed payment effectively becomes an un-arranged payment holiday over that period and an informal loan extension. The loan is technically in default (or arrears) but is otherwise performing as expected and this aspect alone does not necessarily evidence hardship.

ADVERTISING

19. With respect to regulation 4AL, we repeat the comments in our submission on the CCCFA Discussion Document in August 2018 that, in our view, the disclosure of annualised interest rates for short-term loans (i.e., those with a duration of less than 12-months) can result in the disclosure of interest rates that can never apply. For instance, SMB has interest accumulation caps in its loan agreements that stop interest accruing after, say, 60-days. Grossing up a daily or monthly interest rate to an annualised rate can consequently cause the presentation of a rate greater than that which can ever be charged, i.e., the annualised interest rate is not 365 days multiplied by the daily interest rate.

20. Does this approach mean we should disclose the maximum potential interest rate that would be charged each year assuming no cap or the interest rate after applying the cap? This issue will be further complicated by the interest rate cap and total cost of credit cap for high-cost consumer credit contracts (**HCCC**). A HCCC cannot double under section 45A. Does this mean that a creditor should disclose an interest rate of 100% as the finance cost cannot legally be higher? The ability to compare rates would, therefore, become very difficult. We note that this provision does not refer to the "weighted average interest rate" concept, which might overcome this issue.

21. We think there should be the flexibility to disclose a daily interest rate (or other reference period interest rates such as weekly or monthly) for loans with a contractual duration of

less than 12-months. In our view, it is equally misleading and confusing for consumers to be presented with an annualised interest rate that can never apply. You should consider having separate rules for loans with an intended duration of less than 12-months or for HCCCs.

22. Many borrowers with an adverse credit history (e.g., they have been bankrupt) may have overcome their financial difficulties and now be creditworthy borrowers. However, many creditors may not wish to consider such persons for loans merely because of their history. It is important that such borrowers can easily find and access creditors that are willing to consider their loan applications. A blanket prohibition on advertising "bankrupt-OK" and "bad credit history-OK" could make it more difficult for such persons to find creditors that are willing to consider their loan applications. We are concerned that the wording of regulation 4AN(b) could be interpreted as a ban and adversely impact such persons.

DEBT COLLECTION DISCLOSURE

23. Although potentially outside the scope of the Exposure Draft and related Regulations, further clarity is needed on the date debt collection starts and, in particular, the meaning of "payment reminder". This term triggers the obligation to disclose information and it is important that creditors can conclusively determine this date given the consequences of ill-timed disclosure and the prospect of large fines (even where there is little or no consumer harm).

24. Regulation 24(1)(a) should be providing the contact details of the creditor as at the date enforcement action is commenced rather than at the date of the credit contract as these details may have changed in the interim.

25. We do not understand why a debtor's purpose is relevant and needs to be disclosed under regulation 24(1)(c). The purpose is a determination that must be made by the creditor and, as noted above, the creditor might come to a different determination than the purpose disclosed by the debtor. Regardless, we do not believe this information adds anything towards the identification of the loan. This provision would be better

placed to refer to the loan type or product name if the intention is to aid the debtor identifying the loan.

26. We are concerned that regulation 5A specifically refers to *MoneyTalks* and in effect establishes a statutory monopoly with respect to who is a "financial mentoring service". We see no need to refer to a specific organisation and believe this regulation should be drafted in more generic terms to allow other enterprises to offer these services and receive this referral benefit.

OTHER REGULATIONS INSERTED BY THE BILL

27. We would welcome further guidance or clarification on regulation 4AAB, particularly as to what constitutes advertisement of a HCCC as distinct from generic brand or company advertising by a high-cost creditor. For instance, if a business that solely offered HCCCs placed a banner advertisement showing only its brand name and no information about any credit offer would that be sufficient to constitute "advertising" or inducing a person to inquire about an agreement? Would the position be different if the creditor offered HCCCs and non-HCCCs?

28. We repeat our comments above regarding the reference to *MoneyTalks*. This provision should refer to a "financial mentoring service".

CONTENT OF THE ANNUAL RETURN

29. The current list of the types of information that should be provided as part of the annual return is extensive. The collation, verification and presentation of all this information will place a considerable burden on creditors and carry a significant compliance cost. We would encourage MBIE to carefully consider the intended purpose for which this information is being gathered and tightly target the information request to achieve this purpose.

30. Information should be gathered to help MBIE better understand the size and composition of the market, including market segments (consumer credit contracts and HCCCs). Some of the information listed in Section 10 of the Exposure Draft becomes highly segmented and we question its value on a cost v benefit basis. We also note that information with more qualitative characteristics will be far harder to gather and analyse.

31. The collation of this information may require systems changes and potentially new identifying tags to be applied to loan accounts. To ease the administrative burden, it would be beneficial to have the criteria published as soon as possible and potentially exclude loans written prior to the implementation of these requirements so that creditors can ensure the systems are capable of retrieving this information on an automated basis. Any manual collation requirements would be extraordinarily difficult.

32. We would also draw your attention to the annual return that is required by "reporting entities" under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. Significant loan information is provided as part of that annual return. It would make sense for these obligations to be aligned to remove duplication and reporting the same information to different government agencies.

Thank you for the opportunity to submit on these proposals. If you require any further comments or clarification, then we would be pleased to do so.

Yours sincerely

SAVE MY BACON LIMITED

Paul Park
Director