

## **CREDIT CONTRACT AND CONSUMER FINANCE AMENDMENT REGULATIONS 2020**

1. These are the joint submissions of Toyota Finance New Zealand Limited and Oxford Finance Limited to the Ministry of Business, Innovation and Employment in response to the exposure draft of the Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2020 (the "**Regulations**").
2. These submissions principally address two main issues:
  - (a) *Expense Verification*: the obligation under Regulation 4AG(1)(b) and (c) to verify Relevant Expenses with reference to 90 days of bank / credit card transactions and to make enquiries about cash withdrawals, as part of the assessment of the borrower's likely Relevant Expenses; and
  - (b) *Advertising*: the requirement under Regulation 4AK(3) for the total amount of payments and interest rate(s) to be given equal prominence to any payment amount referred to in an advertisement.
3. Statistics and data to support the first main submission are set out in Appendix One.
4. Additional submissions on minor issues are included in Appendix Two.

### Toyota Finance New Zealand Limited

5. Toyota Finance is a wholly owned subsidiary of one of the world's largest carmakers (Toyota Motor Corporation) of Japan.
6. Toyota Finance is the largest captive motor vehicle financier in New Zealand. The core business of Toyota Finance is providing finance and leasing solutions which are offered through authorised vendors (both Toyota & Lexus Motor Vehicle dealers) and directly.
7. Toyota Finance offers retail financing, wholesale finance, fleet funding and insurance solutions for business and consumer customers.
8. As at 31 March 2019 [redacted].

### Oxford Finance Limited

9. Turners Automotive Group Ltd is listed on the NZX and owns Oxford Finance as well DPL Insurance, EC Credit Control and Turners.
10. Oxford Finance principally provides motor vehicle finance through motor vehicle dealers and broker introducers, the largest of which is Turners network.
11. At 31 March 2019 the [redacted].

### General Position

12. Subject to the particular issues identified in these submissions, both Toyota Finance and Oxford Finance support the content of the Regulations in general, and if there are any changes, both Toyota Finance and Oxford Finance would prefer those to be clear and prescriptive in content, rather than the opposite approach.

**Obligation to verify borrower's relevant expenditure based on at least 90 days of transaction records – Regulation 4AG**

13. Toyota Finance and Oxford Finance with one exception, support the process and obligations in Regulation 4AG to collect and verify expenditure.
14. Toyota Finance and Oxford Finance are concerned as to the impact which Regulation 4AG(1)(b) and (c) will have on those credit worthy borrowers who have little to no risk of ever defaulting.
15. This part of the submission advocates for one exception to Regulation 4AG.
16. This submission is more important to Toyota Finance because of the segment Toyota Finance operates in. That difference is illustrated by comparing the average loan amount and average credit scores of Toyota Finance and Oxford Finance customers set out in Appendix One.
17. Toyota Finance enters into approximately [redacted] consumer credit contracts in any 12 month period.<sup>1</sup> In each of those contracts a consumer will borrow an average of [redacted] for an average term of [redacted] months. The annual value of lending in respect of those contracts ranges from [redacted].
18. Of the approximately [redacted] consumer credit contracts Toyota Finance enters annually:
  - (a) Toyota Finance will issue approximately [redacted] repossession warning notices on average at some time in the first 12 months of the agreement; that is [redacted] of all consumer credit contracts; and
  - (b) Toyota Finance on average will issue approximately [redacted] warrants per annum to repossess; that is [redacted] of all consumer credit contracts.
19. Oxford Finance enters into on average [redacted] consumer credit contracts per annum and of those contracts an average of [redacted] per annum reach repossession stage during the first 12 months.
20. The proposed Regulations would add significant unnecessary steps and costs for all consumers so that lenders can identify those borrowers who may suffer substantial hardship in making payments. Both Toyota Finance and Oxford Finance believe that the Regulations should focus on identifying and protecting the interests of borrowers who may be unable to afford payments without imposing unnecessary costs and steps on consumers generally.
21. What concerns both Toyota Finance and Oxford Finance is that a significant proportion of their customers have no problems at all. The application of Regulations 4AG(1)(b) and (c) to those customers would have the following expected consequences:
  - (a) Toyota Finance and Oxford Finance would likely be perceived by those customers as unnecessarily intruding into their privacy in relation to how they choose to run their lives on a day to day basis;
  - (b) the average time a customer is involved in the credit application process would likely increase from 60 minutes to potentially over 3 hours. This is due to the iterative process

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<sup>1</sup> These submissions used the first 12 months of a consumer credit contract as the measurement period because if a default is going to occur there is a strong likelihood it will occur in the first 12 months.

- proposed between lender and customer under Regulations 4AG(1)(b) and (c) to verify the expenditure information;
- (c) the average time to internally assess and verify expense information from application to credit approval would substantially increase;
  - (d) the likely cost of establishment fees and third party fees to set up an agreement would likely increase from circa \$350 to potentially over \$500 (depending on the length of the investigation); and
  - (e) the time taken to complete motor vehicle sale agreements at point of sale would therefore significantly increase. This presents a real commercial risk to retailers of customers walking away, or deciding to purchase elsewhere, in order to avoid the inconvenience of that process (noting that customers will not typically expect to bring with them the extensive information contemplated by Regulations 4AG(1)(b) and (c) when purchasing a vehicle).
22. In turn, Toyota Finance and Oxford Finance are therefore concerned that the proposed Regulation 4AG(1)(b) provides retail banks with a competitive advantage over non-bank lenders. That is because a borrower's bank already holds most (if not all) of the data required by Regulation 4AG(1)(b) and is therefore able to access and process that data without any inconvenience to the borrower. As well, prospective borrowers may well be more accepting (by necessity) of their bank having access to their personal transactional information, but may be reluctant to share that level of information with a third party financier.
23. Toyota Finance and Oxford Finance have reviewed consumer credit contract defaults in detail to identify if there are factors, trends or mechanisms that can be used to determine, with a high degree of confidence, that a default is unlikely. Both Toyota Finance and Oxford Finance have sought to identify what approach could be practically and readily used so as to reduce the personal intrusions, time and costs for those that have a high probability of never defaulting.
24. Toyota Finance and Oxford Finance considered a number of options that might be used to limit some of the steps required. Those included exclusions based on gross income (similar to the wealthy investor type exemptions), the value of net assets (likely to exclude most home owners), credit scores and the amount of the forecast surplus that exists after the proposed loan repayment as a percentage of income.<sup>2</sup>
25. Having considered those options, Toyota Finance and Oxford Finance believe that an objective, reliable and consistent factor is the credit ratio produced by credit reporting agencies using comprehensive reporting.

#### Credit Scores and Credit Ratios

26. The three credit reporters in New Zealand are Centrix, Equifax and Illion. Each allocate different credit scores to the population in their databases, using a credit score out of 1000.

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<sup>2</sup> See paragraphs 47 and 48 for detailed conclusions and reasons.

27. What determines a person's credit score is the risk that a borrower will be "bad". Taking Centrix's credit score as an example:

<b>Credit Score</b>	<b>Risk that a Customer will be bad</b>
100	90.91%
200	83.33%
300	71.43%
400	50.00%
500	29.41%
600	14.93%
650	10.28%
675	8.45%
700	6.90%
725	5.65%
800	3.03%
900	1.30%
1000	0.55%

28. Using the above table there is an 8.45% chance that someone with a credit score of 675 will be bad. "Bad" in this context means the risk that the borrower will be more than 90 days overdue at any time – regardless of whether or not the late payments are made good.
29. Every credit score has a corresponding risk percentage which is also referred to as the credit ratio because frequently it is expressed as a ratio. Credit reporters periodically adjust a person's credit score based on the credit ratios.
30. A credit ratio is a limited tool because it focuses only on the probability of defaults. It does not factor in income, surplus or recent changes to personal circumstances. That said it is an extremely useful fact based tool to indicate whether the borrower has previously had difficulty meeting his or her obligations.
31. Toyota Finance and Oxford Finance submit that a credit score is a useful and valid tool , as it is based on the consumer's own credit history as well as other demographic attributes.

#### What do the Regulations require

32. The exposure draft Regulations does not differentiate at all between borrowers' quite different circumstances, or the level of borrowings or length of the borrowing term.
33. In relation to every credit application, Regulation 4AG requires the lender to:
- obtain from the borrower a list of categorised Relevant Expenses;
  - verify the Relevant Expenses with reference to 90 days of bank / credit card transactions and to make enquiries about cash withdrawals;
  - ask the borrower about likely changes to Relevant Expenses;
  - obtain a credit report to identify any other Relevant Expenses.

- (e) reconcile any conflict between this information.
34. Regulation 4AH then requires the lender to compare the results of the exercise carried out under Regulations 4AG and compare that against what might be a “reasonable cost of those expenses”, with the Lender being required to use the higher amount for the purpose of determining the borrower’s likely relevant expenses for the purpose of Regulation 4AE. Comments and submissions on Regulation 4AH are addressed in Appendix Two.

What does the data show

35. Based on past experience and the data set out in Appendix One, Toyota Finance and Oxford Finance believe that Regulation 4AG(1)(b) – (c) should not apply for the majority of consumers where the lender can rely on the application data (including categorised expenses) provided by the consumer and credit scoring provided by credit reporters which demonstrate a sufficiently high credit score. The data provided in Appendix One shows that borrowers who have a credit score of 675 or more would be very unlikely to have any sort of default.
36. The consumer loans referred to in the data relied on the borrower’s statement of expenditure without the type of reconciliation contemplated by the draft Regulations.
37. The experience of both Oxford and Toyota suggests that a loan that is likely to cause substantial hardship or affordability issues is more likely than not to have defaults in the first twelve months. For that reason the data focuses on the first twelve months of new consumer lending.

*Oxford*

38. The average credit score of borrowers who were issued repossession notices was [redacted] in 2018 and [redacted] in 2019 respectively. That reflected [redacted] and [redacted] of the total number of agreements respectively and more positively, that [redacted] of the consumer agreements entered into did not result in any formal steps. It is worth noting that the percentage of contracts that proceeded to repossession was tiny.
39. The average credit scores of those loans which proceeded to repossession were lower than the credit scores for those borrowers issued repossession warning notices. However the highest credit score for those loans which proceeded to repossession reduced significantly.

*Toyota*

40. The average credit score of borrowers who were issued repossession notices was [redacted] in 2016, [redacted] in 2017, [redacted] in 2018 and [redacted] in 2019. That reflected [redacted] of the total number of agreements respectively and more positively most recently [redacted] of the consumer agreements entered into did not result in any formal steps.
41. The average credit scores of those loans which proceeded to repossession were lower than the credit scores for those borrowers issued repossession warning notices. The highest credit score for those agreements which proceeded to repossession reduced significantly and trend down from 2016 to 2019 ending with an average of [redacted] in 2019.

## *Conclusions*

42. In respect of Toyota, the average credit score over four years of data in respect of agreements where a repossession warning notice was generated is [redacted] and for Oxford that number over two years of data is [redacted].
43. There are some outliers in the credit score analysis. However when looking at the numbers and volumes, and assuming the data is used to set a credit score which might exempt a borrower from undergoing the steps required by Regulation 4AG(1)(b) and (c), it seems that a conservative score that might trigger an exemption would be 675.

## Submission

44. Toyota Finance and Oxford Finance suggest that the obligations in Regulation 4AG(1)(b) and (c) should only apply if a prospective borrower's credit ratio is less than 8.45% (equivalent to a credit score of 675) using the Centrix scoring method).
45. The application details provided by the consumer would be required (under Regulation 4AF(1) and 4AG(1)(a)) to include certain income and expense information and the lender would still be required to ask about changes in relevant expenses, and to obtain a credit report under Regulation 4AG(1)(e). The only difference is the absence of an obligation to verify Relevant Expenses against 90 days of bank / credit card transactions which Toyota Finance and Oxford Finance submit will deliver significant benefits to customers who are not likely to default with those cost savings being spread over all customers.
46. For the avoidance of doubt, Toyota Finance and Oxford Finance both agree that the verification process in Regulation 4AG(1)(b) and (c) remains important for the borrowers whose credit score does not meet the prescribed threshold.

## Other Methods

47. Toyota Finance and Oxford Finance did not consider:
  - (a) verifiable gross income and the value of net assets were appropriate substitutes for the application of Regulations 4AG(1)(b) and (c) because:
    - (i) there would have to be a subjective value judgment involved in setting any threshold;
    - (ii) it is difficult to track/prove the threshold is reliable;
    - (iii) inevitably the threshold would have to err on the high side so that it would not provide enough relief;
    - (iv) it would not take account of obvious historic issues which are identified in a credit report;
    - (v) it gives no credit to borrowers whose credit history demonstrates an ability to meet payments, even on comparatively most incomes;
    - (vi) it would not take account of any current commitments.

- (b) the amount of the forecast surplus that exists after the proposed loan repayment (as a percentage of income) was an appropriate substitute for the application of Regulations 4AG(1)(b) and (c):
  - (i) for all of the reasons set out in sub-paragraph (a) above; and
  - (ii) because that method alone relies solely on a borrower's unverified forecast of expenditure, and experience suggests borrowers' tend to underestimate expenditure;
  - (iii) even verified income can be subject to significant changes, for example where benefit types change, or child support income starts or stops.
- 48. If forecast surplus is a test that the Ministry intends to consider further then both Toyota Finance and Oxford Finance would like to make further submissions on that particular issue including how it might work and what an appropriate surplus might be.
- 49. Toyota Finance and Oxford Finance are of the view that reference to a credit score provides the best substitute, but they would be open to a combination of measures (including a credit score and one or more of the above methods) as a substitute for the application of Regulations 4AG(1)(b) and (c), particularly if that combination means that the threshold for the applicable credit score should reduce.
- 50. It may be appropriate to review and amend by regulation the prescribed level of the particular credit score threshold. We note that the annual report which financiers are required to provide could include data which would assist with any such review process.

### **Advertising – 4AK(3)**

- 51. Regulation 4AK(3) applies where an advertisement refers to a payment amount. It will require the advertisement to include the total amount of all payments displayed as prominently as any one payment or the interest rates/range of rates as prominently as any one payment.
- 52. Both Toyota Finance and Oxford Finance submit that:
  - (a) where the proposed loan has a stated term in calendar months with a deposit and equal monthly payments until the end of the term, there is no benefit highlighting the total amount payable and/or interest rates to the degree proposed; and
  - (b) there is potentially harm where a regular period payment advertised is based on variable deposit amounts and/or structured finance payments which are used to lower the weekly or monthly payments and that information is not readily apparent, or where there is a range of interest rates and loan periods and the lowest interest rate with the longest loan term is used.
- 53. In the industries which both Toyota Finance and Oxford Finance operate, the reasons why elevating the prominence of the total amount payable could be misleading include:
  - (a) it is fairly common for borrowers to add different optional insurance products and/or features to vehicles that are financed. Those amounts can vary and can be significant as a percentage of the vehicles value and can be a significant increase on the total amount payable; and

- (b) where the borrower, using a trade in or cash, changes the amount of the deposit and that affects the total amount payable.
54. Toyota Finance and Oxford Finance submit:
- (a) the best place to disclose total amount payable is in the disclosure statement before any agreement is entered into because that takes into account details specific to the borrower. At that point the borrower is not committed; and
- (b) the degree of emphasis the draft Regulations require for the total amount payable and or interest rate(s) is not in proportion to the benefit because it is almost certain the total amount stated will apply to no one particular borrower.
55. In motor vehicle finance, a weekly or monthly payment is a key selling tool for the vendor of the motor vehicle. Toyota Finance and Oxford Finance have never had any complaints or feedback about a purchaser being confused about the total amount payable or interest rates. That is most likely because obligations exist to publish interest rates online and have them available on premises as well as having all the information set out pre contract, in the disclosure statement.
56. If Regulation 4AK(3) is to be retained for all forms of consumer credit contracts (including those with standard monthly terms), Toyota Finance and Oxford Finance submit the prominence required in Regulation 4AK(3) should be:
- (a) to ensure the total amount payable is “easily readable”<sup>3</sup> or
- (b) in the event that “easily readable” is not accepted, to ensure the information is displayed “no less than 50% of the font size used to state the payment amount”; and
- (c) when the advertisement is digital, or available with “one click” in which case it should be clear that additional information is available by clicking on a hyperlink.
57. To address the confusion or misleading nature of regular payments, where those include structured finance amounts, Toyota Finance and Oxford Finance submits that Regulation 4AK(2) should be amended as follows:
- (2) *The advertisement must state,—*
- (a) *if ascertainable, the total amount of the payments (but only if the contract would, on the assumptions set out in Schedule 1, be paid out within 7 years of the date on which credit is first provided under the contract),*  
*or*
- (b) *in any other case, the annual interest rate or rates for that class of credit contracts (with the rate or rates being expressed in terms of a percentage), and*
- (c) *the term, the amount of the deposit and any other lump sum payments (including when those are due) which would be required.*
58. Toyota Finance and Oxford Finance note that the Regulation does not provide any guidance on how obligations as to "prominence" might be discharged in different modes of advertising, such as TV, radio or (in particular) digital marketing. While both Toyota Finance and Oxford Finance

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<sup>3</sup> Easily readable is the standard currently used in the Credit Contracts and Consumer Finance Regulations 2004 for minimum repayment warnings and the Disclosure Statement. See regulation 4E(2) and 13(1)(a) Credit Contracts and Consumer Finance Regulations 2004 for existing references to “easily readable” as an example of using “easily readable” as the appropriate standard.



would prefer detailed rules, in particular for digital marketing, neither have experienced those types of issues being of any concern to borrowers and the focus on affordability is appropriate.

## Appendix One

### Data related to the submission in respect of the obligation to verify Relevant Expenses

#### Oxford Finance

##### Summary Of Consumer Credit Contract Lending (Redacted)

<u>12 months ended</u>	<u>31/12/2018</u>	<u>31/12/2019</u>
Total dollar value		
Number of contracts		
Average amount borrowed		
Average term (months)		
Credit Score Minimum		
Credit Score Maximum		
Credit Score Average		

##### Of The Agreements Entered Into In This Period

<u>Data in respect of repossession warning notices (RWN) issued</u>	<u>31/12/2018</u>	<u>31/12/2019</u>
Number of contracts that had RWN issued		
% of contracts that had RWN issued		
Credit Score Minimum		
Credit Score Maximum		
Credit Score Average		

<u>Data in respect of post repossession notices (PRN) issued</u>	<u>31/12/2018</u>	<u>31/12/2019</u>
Number of contracts that had PRN issued		
% of contracts that had PRN issued		
Credit Score Minimum		
Credit Score Maximum		
Credit Score Average		

**Toyota Finance**

**Summary Of Consumer Credit Contract Lending (Redacted)**

<b><u>12 months ended</u></b>	<b><u>31/12/2016</u></b>	<b><u>31/12/2017</u></b>	<b><u>31/12/2018</u></b>	<b><u>31/12/2019</u></b>
Total dollar value				
Number of contracts				
Average amount borrowed				
Average term (months)				
Credit Score Minimum				
Credit Score Maximum				
Credit Score Average				

**Of The Agreements Entered Into In This Period**

**Data in respect of repossession warning notices (RWN) issued**

	<b><u>31/12/2016</u></b>	<b><u>31/12/2017</u></b>	<b><u>31/12/2018</u></b>	<b><u>31/12/2019</u></b>
Number of contracts that had RWN issued				
% of contracts that had RWN issued				
Credit Score Minimum				
Credit Score Maximum				
Credit Score Average				

**Data in respect of post repossession notices (PRN) issued**

	<b><u>31/12/2016</u></b>	<b><u>31/12/2017</u></b>	<b><u>31/12/2018</u></b>	<b><u>31/12/2019</u></b>
Number of contracts that had PRN issued				
% of contracts that had PRN issued				
Credit Score Minimum				
Credit Score Maximum				
Credit Score Average				

## Appendix Two

### Additional Submissions

#### Definition of Relevant Expenses – 4AD

59. The definition of Relevant Expenses is central to the provisions in Regulation 4AG which relate to determining affordability.
60. In most cases Relevant Expenses will be verified against bank records.<sup>4</sup> When that process occurs there will be a gap between what is currently described as “any regular or frequently recurring discretionary expenses”<sup>5</sup> and total expenses. That gap will be expenditure that is truly discretionary, which the borrower may reduce in order to accommodate payments under the relevant credit contract.
61. Toyota Finance and Oxford Finance submit that it will assist and improve transparency with the borrower and the reconciliation process required in Regulation 4AG1(b) if the definition of Relevant Expenses is amended to include all expenditure.
62. Toyota Finance and Oxford Finance submit the definition of Relevant Expenses is amended as follows:

*relevant expenses means—*

- (a) *fixed financial commitments, including any child support that is payable under the Child Support Act 1991 and payments on any debts:*
- (b) *living expenses, including accommodation costs, insurance, utilities, food and groceries, personal expenses (including clothing and personal care), costs associated with dependents if applicable (such as school fees and child care), medical expenses, and transport expenses:*
- (c) *any regular or frequently recurring ~~discretionary~~ expenses that are reasonably likely to continue if credit is provided:*  
*but excludes any discretionary expenses that the borrower indicates are able to be eliminated if credit is provided.*

#### Borrower to provide a categorised statement of their Relevant Expenses – 4AG(1)(a)

63. Toyota Finance and Oxford Finance submit that Regulation 4AG(1)(a) is amended to permit the lender to construct a list of expenses for the borrower to confirm.
64. For example Regulation 4AG(1)(a) would read:
- (a) *Either:*
- (i) *create a categorised statement of Relevant Expenses by carrying out the process set out in Regulation 4AG(1)(b) and (c) and ask the borrower to verify the accuracy of that categorised statement; or*

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<sup>4</sup> Regulation 4AG(1)(b) Credit Contracts and Consumer Finance Amendment Regulations 2020.

<sup>5</sup> “An example of regular or frequently recurring discretionary expenses might be that the borrower regularly purchases cigarettes, or sends money to family every month, and wishes to continue to do so while making debt repayments” – paragraph 50, Exposure Draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020, Commentary and request for submissions, November 2019.

(ii) *obtain from the borrower a categorised statement of their current Relevant Expenses.*

65. The reasons for this include:

- (a) It's more likely than not the process in Regulation 4AG(1)(b) and (c) will involve software which will make categorising Relevant Expenses faster and more accurate than if the borrower were to do that manually.
- (b) It is fairly common for borrowers to underestimate Relevant Expenses. Allowing the lender to prepare the categorised statement of Relevant Expenses based on actual records will reduce the reconciliation time and more importantly the potential for the borrower to be embarrassed when asked to reconcile their categorised statement against actual records (assuming the borrower underestimated their Relevant Expenses).

Lender to ask the borrower about likely changes to Relevant Expenses – 4AG(1)(d)

66. Toyota Finance and Oxford Finance submit that Regulation 4AG(1)(d) is amended so as to make enquiry as to expenses which are truly discretionary (and may therefore be excluded by the lender when estimating Relevant Expenses).

67. For example Regulation 4AG(1)(d) would read:

*(d) ask the borrower about any likely changes to their relevant expenses, including any discretionary expenses that the borrower indicates are able to be eliminated if credit is provided*

68. This amendment supports the change to the definition of Relevant Expenses referred to above.

Lender to compare the Borrower's living costs against reasonable living costs – 4AH(1)(a)

69. Living costs are one part of the definition of Relevant Expenses:

*living expenses, including accommodation costs, insurance, utilities, food and groceries, personal expenses (including clothing and personal care), costs associated with dependents if applicable (such as school fees and child care), medical expenses, and transport expenses:*

70. Commentary to the draft Regulations identifies two objectives:

- (a) borrowers may understate or omit certain expenses (inadvertently or sometimes deliberately);
- (b) the level of expense may not be readily identifiable from transaction records.<sup>6</sup>

71. Toyota Finance and Oxford Finance submit:

- (a) the reconciliation or preparation of Relevant Expenses from at least 90 days of transaction records achieves the first objective;
- (b) if the level of historical living expenses is not able to be identified there is a wider issue and it would be prima facie irresponsible for the lender to advance credit, which achieves the second objective;

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<sup>6</sup> Paragraph 54, Exposure Draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020, Commentary and request for submissions, November 2019.

- (c) the reconciliation to actual expenses in Regulation 4AG is more meaningful and relevant than any comparison to a hypothetical “average” or reasonable standard;
  - (d) no publicly available and comprehensive “reasonable living cost” metric currently exists to allow a lender to compare “actual” against “reasonable”; and
  - (e) because no reasonable living cost metrics are published, the reality is that an individual credit analyst will inevitably substitute their view of whether the borrower’s expenses are reasonable in the borrower’s circumstances, and the analyst is likely to simply conclude that the borrower’s actual historical expenses will, in most cases, be reasonable in the borrower’s circumstances.
72. Toyota Finance and Oxford Finance submit that the best that could be done is for the lender to reconcile the actual expenses against all it knows about the borrower having regard to the borrower’s position including income, the number of dependents and, if relevant, their ages, and the location in which the borrower lives, and that exercise is effectively required by Regulation 4AG.
73. It would be an unusual situation if a reconciliation of 90 days of complete and comprehensive transaction records did not provide the best picture of the borrower’s circumstances. A comparison of those circumstances to a hypothetical standard is meaningless in relation to affordability of the particular borrower. And if the borrower’s actual circumstances do unexpectedly deteriorate after credit is advanced the borrower is quite likely entitled to make a hardship application.

#### Income and Expenses of a Partner

74. It is reasonably common that partners prefer (and sometimes need) to use their joint income and expenses in order to establish affordability in circumstances where only one of the partners is the borrower/owner of the asset being financed. It has become common practice for financiers to lend based on joint incomes where there is just one borrower and there is nothing specific in the Act or the Regulations which addresses or contemplates this. This conduct was recently the subject of a warning letter issued by the Commerce Commission.<sup>7</sup>
75. There are a range of issues that relate to people in relationships including:
- (a) Are there any circumstances where a lender could responsibly take account the income of a partner in determining affordability in circumstances when the other partner is the sole borrower?
  - (b) When is it reasonable to consider that two people are in a relationship? Is there a period of time or some other test?
  - (c) In circumstances where one partner is the sole borrower, to what extent or proportion should joint/shared expenses be taken into account for the purpose of determining affordability?

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<sup>7</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0023/182138/Warning-letter-to-WeCare-Finance-Limited-10-October-2019.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0023/182138/Warning-letter-to-WeCare-Finance-Limited-10-October-2019.pdf) in particular paragraph 23

- (d) Is it responsible to lend to co-borrowers on a joint and several basis when one partner has substantively all of the income and the other, if pursued by the lender, has no income? This particular issue must also regularly arise in the context of home lending.
76. Toyota Finance and Oxford Finance submit that it would be helpful if the Regulations addressed the issues in paragraph 75, particularly because of the Commerce Commission's position on that issue which is set out in the warning letter to WeCare Finance Limited.

#### Structured Finance

77. The Regulations do not currently address structured finance arrangements.
78. Toyota Finance and Oxford Finance submit that it is important to be as clear as possible in relation to different types of finance.
79. It is also possible that a more prescriptive focus on affordability in relation to regular payments may move the market to structured finance (with larger, more infrequent payments) in an effort to reduce regular payments.
80. In the motor vehicle industry there are generally two types of structured finance: promotional and standard.
81. An example of promotional is where the purchase price of a vehicle is spread over three or four payments, for example:
- (a)  $\frac{1}{3}$ <sup>rd</sup> deposit,  $\frac{1}{3}$ <sup>rd</sup> at the end of year 1 and  $\frac{1}{3}$ <sup>rd</sup> at the end of year 2; or
  - (b)  $\frac{1}{4}$  deposit,  $\frac{1}{4}$  at the end of year 1,  $\frac{1}{4}$  at the end of year 2 and  $\frac{1}{4}$  at the end of year 3.
82. Typically promotional structured finance is low interest or interest free.
83. Standard structured finance will require a lump sum payment at the end of the agreement or one or two lump sum payments and/or a lump sum payment at the end of the agreement.
84. Toyota Finance and Oxford Finance submit that the Regulations should apply to structured finance and that:
- (a) in relation to mid-term payments, rather than the "income less expenses" requirement in Regulation 4AE(b)(i), the requirement should be that:
    - (i) the aggregated monthly surplus of income less expenses must be sufficient to add or exceed any mid-term payments; or
    - (ii) the borrower must hold (or demonstrate that it will hold) sufficient cash, or be able to identify an unconditional right to receive cash in the future (for example an unconditional right to receive fixed bonus which would need to be verified under the Regulation 4AF) in order to meet any mid-term payments when they fall due; and
  - (b) in relation to end of term payments, the same requirement should be as set out above for mid-term payments, but with the ability to take into account any option the borrower may have to confirm to the lender that the borrower will sell and/or trade in the vehicle at the end of the term.

#### Exceptional Circumstances - 4AE(b)(iii)

85. Regulation 4AE sets out the general rule which usually will be “the borrower’s likely income exceeds their likely relevant expenses, allowing a reasonable surplus to pay or save for other expenses”.<sup>8</sup>
86. Regulation 4AE(b)(iii) states:
- The lender must (b) be satisfied on reasonable grounds that it is not likely that the borrower will suffer substantial hardship in making the payments under the agreement because (iii) there are other exceptional circumstances that mean that money (other than likely income) will be available to meet the payments under the agreement (and to meet likely relevant expenses and to have a reasonable surplus to pay or save for other expenses).”*
87. Toyota Finance and Oxford Finance submit that the general rule in Regulation 4AE(b)(iii) is too wide, provides too much lender discretion and should include further restrictive conditions if a lender is to use it. That is because even if the Regulation is expressed objectively, lenders inevitably apply their own subjective views and maintain those are objective unless and until a Court determines what is objectively correct. That is what occurred with the responsible lending principles from 2015 and there is a risk of the same happening unless there are additional obligations placed on a lender before relying on “exceptional circumstances”.
88. Regulation 4AE(b)(iii) operates separately to the more prescriptive requirements in Regulation 4AF to 4AH. It is not clear if the reference to exceptional circumstances means circumstances which are exceptional to the borrower or exceptional circumstances generally. The former is the lower standard. For example an expected inheritance might be exceptional for the borrower but may not be exceptional generally a likely bonus may be exceptional for the borrower but not exceptional generally. Toyota Finance and Oxford Finance submit that could be made clear by changing the drafting.
89. Toyota Finance and Oxford Finance submit that the Regulations 4AE include an additional clause which states:
- Where the borrower is satisfied on reasonable grounds that it is not likely that the borrower will suffer substantial hardship because of exceptional circumstances:
- (i) the onus of proving exceptional circumstances in accordance with this regulation is on the creditor; and
  - (ii) the creditor must take reasonable steps to verify the exceptional circumstances using reliable documentary evidence.

#### **Annual Return – section 116AAA Credit Contracts Legislation Amendment Act 2019<sup>9</sup>**

90. Toyota Finance and Oxford Finance have two submissions in respect of the content of the annual return required under s 116AAA:

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<sup>8</sup> Regulation 4AE((b)(i) Credit Contracts and Consumer Finance Amendment Regulations 2020.

<sup>9</sup> Paragraph 125 onwards of the Exposure Draft of the Credit Contracts and Consumer Finance Amendment Regulations 2020, Commentary and request for submissions, November 2019.



- (a) In respect of paragraphs 140 to 144 – lenders frequently have no visibility or do not hold or have any right to access this type of data because that is held, managed and owned by a third party and suggest this requirement is deleted or alternatively there are statutory amendments required if Parliament requires financiers to hold this information.
- (b) grandfathering provisions are included so that any annual return only need include data relevant to contracts entered into from 1 January 2020.