



## COVERSHEET

<b>Minister</b>	Hon Kris Faafoi	<b>Portfolio</b>	Minister of Commerce and Consumer Affairs
<b>Title of Cabinet paper</b>	Residential Earthquake Prone Buildings Loan Scheme: Request from Kāinga Ora for an Exemption under the Credit Contracts and Consumer Finance Act 2003	<b>Date to be published</b>	22 July 2020

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
17 June 2020	Residential Earthquake Prone Buildings Loan Scheme: Request from Kāinga Ora for an Exemption under the Credit Contracts and Consumer Finance Act 2003	<i>Office of the Minister of Commerce and Consumer Affairs</i>
17 June 2020	Cabinet Economic Development Committee Minute of Decision - Residential Earthquake Prone Buildings Loan Scheme: Request from Kāinga Ora for an Exemption under the Credit Contracts and Consumer Finance Act 2003	<i>Cabinet Office</i>
28 May 2020	Impact Summary: Residential Earthquake Prone Buildings Loan Scheme: Kāinga Ora CCCFA Exemption	<i>MBIE</i>

### Information redacted

**YES / NO** [select one]

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

# Impact Summary: Residential Earthquake Prone Buildings Loan Scheme: Kāinga Ora CCCFA Exemption

## Section 1: General information

**Purpose**

The Ministry of Business, Innovation and Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by the Minister of Commerce and Consumer Affairs.

**Key Limitations or Constraints on Analysis**

This Impact Summary (**IS**) is confined to assessment of an application for exemption from the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) submitted by Kāinga Ora. It does not consider any policy issues beyond the specific issues raised by Kāinga Ora as requiring exemption, and the options identified are to either agree to the exemption (with appropriate terms and conditions), or to decline the exemption (the status quo). The analysis in this IS relies on evidence provided by Kāinga Ora in its exemption application and subsequent correspondence.

**Responsible Manager**

Monika Ciolek

Competition & Consumer Policy

Building, Resources and Markets

Ministry of Business, Innovation and Employment

28 May 2020

*To be completed by quality assurers:*

**Quality Assurance Reviewing Agency:**

Ministry of Business, Innovation and Employment.

**Quality Assurance Assessment:**

MBIE’s Regulatory Impact Analysis Review Panel has reviewed the attached Impact Summary prepared by MBIE. The Panel considers that the information and analysis summarised in the Impact Summary meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

**Reviewer Comments and Recommendations:**

## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

In July 2017, a new Earthquake-Prone Buildings (**EPBs**) scheme came into effect that requires EPBs to be remediated to specified minimum standards within set timeframes. Without substantial financial assistance, some unit owner-occupiers in Residential Earthquake-Prone Buildings (**REPBs**) (and some household unit owner-occupiers in mixed use EPBs) are likely to face financial hardship meeting their contribution to remediation costs, and may be forced to sell their home/unit. Concerns about this issue are primarily in areas of high seismic risk, such as Wellington city.

In February 2020, Cabinet agreed to a Residential Earthquake Prone Buildings Financial Assistance Scheme (**REPB loans scheme**) to help the owners of residential earthquake prone buildings bring these buildings up to the specified minimum standards.

To be eligible for these loans, unit owners must meet the following criteria:

- The unit owner must be a New Zealand citizen; ordinarily resident in New Zealand or an overseas person allowed under the Overseas Investment Act 2005; and
- The unit owner must be an owner-occupier of the unit for the duration of the loan;
- Those applying must have been declined a loan that covers the full cost of remediation from a registered bank or non-bank deposit taker; or
- Where, if other finance was obtained, it would cause the owner significant financial hardship.

The REPB loan scheme is limited to units purchased before 1 July 2017 that are in a high seismic risk area, are two or more storeys in height, contain three or more household units (or is a household unit within a mixed use building). In addition the building must be subject to a territorial authority-issued EPB notice.

Any loans advanced under the REPB loan scheme would become due when the unit is sold, the owner dies, or ceases to be an owner-occupier. That is, borrowers would not have to make regular re-payments from their income for the duration of their occupation of the unit. Borrowers would however, have the option of making periodic or voluntary repayments to reduce the loan's impact when the unit is disposed of. Interest rates would be set at a below-market rate. Loans are capped at a maximum of \$250,000.

Cabinet has approved \$10,000,000 being made available for lending under the EPB loans scheme. It is estimated that up to 80 loans will be made under the scheme given the amount made available for lending.

Cabinet also decided that Kāinga Ora would be the delivery agent for the scheme. Because the REPB loans scheme involves providing credit to consumers, for household and domestic purposes, the loans would be consumer credit contracts. This means that Kāinga Ora would, in the absence of any exemption, have to comply with the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**).

Kāinga Ora is a Crown Entity under Schedule 1 of the Crown Entities Act 2004. Its prime function is to administer the government's social housing stock. Providing consumer finance is not part of their core business. They consider that compliance with the CCCFA would be overly burdensome and onerous given the nature of the EPB scheme, and the small number of loans likely to be made under the scheme.

The Cabinet decision envisioned that the REPB loans scheme would comply with the CCCFA. However, at the time, the operational implications for Kāinga Ora were not fully identified. These include the implications of amendments to the CCCFA that will enter into force in future (currently no earlier than 1 October 2021).

Compliance with current and future obligations under the CCCFA is likely to impose significant costs on Kāinga Ora that is disproportionate to the number of loans likely to be made. The time taken to achieve compliance also has the potential to delay implementation of the loan scheme, possibly resulting in some unit owners being forced to sell their units, when they might otherwise be eligible for loans under the scheme.

CCCFA obligations which Kāinga Ora considers would be unduly burdensome and onerous include:

- A due diligence duty for directors (in this case the Kāinga Ora board) and senior managers. A breach of this duty may give rise to personal liability of those directors and senior managers. Such liability is inappropriate for a Crown Entity which is not otherwise involved in providing consumer credit, and does not have commercial incentives.
- Fit and proper person test: this will require the Commerce Commission to certify the board and senior managers of Kāinga Ora as fit and proper persons to make EPB loans. As Kāinga Ora's normal business does not involve lending this may be problematic, as the board and senior managers do not have experience or qualifications relating to consumer credit contracts. It may also be inappropriate given that Kāinga Ora's board has already been subject to a Crown entity appointment process.
- Plain language mortgage: Kāinga Ora argues that providing a plain language mortgage would prevent it from using New Zealand's usual default mortgage terms (the ADSL mortgage terms). There would be significant costs involved in drafting a plain language mortgage, which would be disproportionate given the low number of loans likely to be made.
- Affordability and suitability enquiries: The enquiries usually required of lenders are extensive and often inappropriate given the nature of the EPB loans. The loans are available to people who cannot obtain a loan from a bank on affordability or other grounds.
- Disclosure: The CCCFA contains extensive disclosure obligations. The need to meet all of these requirements (and to have policies and procedures to meet ones that may occur but are unlikely, such as request disclosure) would be onerous given the number of EPB Loans to be made. To the extent that any particular disclosure obligations are important in the circumstances, they can be dealt with in the conditions of the exemption.
- Cost justification of fees: The CCCFA contains strict requirements for the cost justification of fees. Kāinga Ora will be required to keep records of the justification of the establishment fee. However, the cost of going through that justification process is very high, given the likely amount to be recovered by that fee. The establishment fee has been set at half the establishment cost with a maximum of \$500, so the maximum amount of fees recovered would \$40,000 at most.

On this basis Kāinga Ora has applied to the Ministry of Business, Innovation and Employment for a full exemption under s138(1)(a) of the CCCFA exempting the EPB loan scheme from being a "consumer credit contract". The exemption is only sought for the EPB loan scheme and would not apply to other similar or identical future schemes. Kāinga Ora has also proposed conditions that would be attached to the exemption to ensure that the interests of borrowers under the EPB loans scheme are adequately protected.

## **2.2 Who is affected and how?**

The main parties involved are Kāinga Ora, and owners of units in REPBs. The purpose of the proposed exemption is to allow Kāinga Ora to support the REPB loan scheme without unnecessary compliance costs or delays.

## **2.3 What are the objectives sought in relation to the identified problem?**

The nature of the issue means that decisions are limited to the question of whether or not to support the exemption sought by Kāinga Ora.

## Section 3: Options identification

### 3.1 What options have been considered?

There are two possible approaches to dealing with the problem described in Section 2:

- provide for an exemption under s138(1)(a) of the CCCFA (a “full” exemption)
- provide for an exemption under s138(1)(ab) of the CCCFA (a “partial” exemption)

Both exemptions can be made subject to terms and conditions. Note that the CCCFA does not use the terms “full” and “partial” exemption.

If a “full” exemption is granted under s138(1)(a) for the REPB loans scheme, then loans made under the scheme would not be consumer credit contracts and therefore not subject to any of the provisions in Parts 1A and 2 of the CCCFA. In this case, Kāinga Ora has proposed to apply a small subset of the provisions of Parts 1A and 2 to the REPB loans, although there is no requirement in s138(1)(a) for the terms or conditions of the exemption to include application of any provisions of the CCCFA.

If a “partial” exemption is granted under s138(1)(ab), loans made under the REPB loans scheme would still be consumer credit contracts for the purposes of the CCCFA. The loans would be subject to all of the provisions of the CCCFA except for those provisions of the CCCFA specified in the exemption regulations.

A “full” exemption is more appropriate where the intention is that the loans be exempted from most or all of the provisions of Parts 1A and 2 of the CCCFA. It is a form of “opt in” provision to the extent that any terms and conditions are consistent with some provisions of Parts 1A and 2.

A “partial” exemption is more appropriate where the intention is that nearly all of the provisions of the CCCFA should apply to a credit contract, with the contract being exempted only from a small subset of the provisions in the CCCFA. It is essentially an “opt out” provision.

In this case Kāinga Ora considers that ensuring compliance of the REPB loans scheme with most of the provisions of Parts 1A and 2 of the CCCFA would be unduly onerous and disproportionate given the nature of the loans scheme, and the small number of loans likely to be made. The terms and conditions they have proposed are those where compliance is considered by Kāinga Ora to be proportionate, and which also ensure that the statutory requirements for an exemption are met. On this basis, MBIE considers that a “full” exemption under s138(1)(a) is most appropriate.

The exemption under s138(1)(a) of the CCCFA, would be on conditions intended to ensure the interests of borrowers who take out loans under the scheme are protected, including that:

- i. The creditor under the EPB loans scheme is Kāinga Ora or any successor in respect of the scheme.
- ii. The loan agreement and loan terms and conditions are in plain language, but with no equivalent requirement for the mortgage terms (to clarify that the

standard ADLS mortgage terms can be used).

- iii. That Kāinga Ora will disclose the matters set out in paragraphs (a), (aa), (e), (g), (h), (i), (j), (k), (m), (n), (p), (q), (r), (t), and (u) of Schedule 1 of the CCCFA in relation to the REPB loans, but only to the extent each such matter is applicable and ascertainable as at the relevant disclosure date, and as if sections 32-35<sup>1</sup> of the CCCFA apply to that disclosure.
- iv. Kāinga Ora will disclose matters set out in sections 19(1)(a) to 19(1)(f) and s19(1)(h) of the CCCFA in relation to the REPB loans at least every 6 months<sup>2</sup> but only to the extent each such matter is applicable and ascertainable as at the relevant disclosure date, and as if sections 32--35 of the CCCFA apply to that disclosure.

In relation to condition (iii), Schedule I of the CCCFA relates to “key information” concerning a consumer credit contract that must be made available to a debtor by a creditor. Under condition 3, a subset of the information required by Schedule 1 will be provided by Kainga Ora.

The key information that Kāinga Ora will provide where applicable and ascertainable is:

- Kāinga Ora’s name and address
- total of all advances made or to be made under the loan contract
- annual interest rates under the load contract
- if there is more than one rate, how each rate applies
- the period (if any) during which the interest rate is fixed
- information about how the annual interest rate is determined
- how interest is calculated, and frequency with which interest charges are debited under the loan contract
- length of any interest free period and when interest will begin to accrue
- description of the credit fees and charges including the amount payable and when it is payable
- how Kāinga Ora’s loss on full prepayment of the loan is calculated and what procedure is used
- description of any security interest that is or may be taken in connection with the loan contract
- default interest charges and fees that may be payable
- frequency with which continuing disclosure statements will be provided
- a statement to the effect that Kāinga Ora consents to receive notices or other communications from the debtor if such consent is given

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<sup>1</sup> Sections 32-35 of the CCCFA set out the standards that a disclosure must meet, and how the disclosure is made.

<sup>2</sup> Section 19(1)(g) of the CCCFA has been excluded from this list due to the technical challenges of producing loan statements with a “next payment” that is not a known amount or date for most of the time, and only becomes a known date once certain events (sale of the unit, death of the owner or ceasing to be an owner occupier) occur. Depending on the exact facts, it may or may not be possible to calculate the expected repayment amount once the future repayment date is known.

Also considered was whether it was feasible for Kāinga Ora to comply with the current obligations under the CCCFA, and then get an exemption for the stricter obligations that will come into force in October 2021. However, the compliance costs for Kāinga Ora under this approach were still considered disproportionate to the size and character of the REPB loans scheme.

The exemption has been considered in accordance with the statutory criteria for granting an exemption in s138(1A) of the CCCFA. This means that the exemption must meet all of the following criteria:

- *The exemption is consistent with and promotes the purposes of the CCCFA (based on s. 138(1A)(a)).*
- *The exemption will not cause significant detriment to consumers (based on s. 138(1A)(b)).*
- *The exemption will relieve compliance obligations that are unduly onerous or burdensome (based on s. 138(1A)(c)(i)).*

In addition, the exemption should only be granted if it will have net economic benefits.

Section 4 (Impact Analysis) focuses on the impacts of the exemption on affected parties, and includes an assessment of whether the exemption will have net economic benefits. Impacts related to the statutory criteria are also discussed, however a full assessment against the statutory criteria is provided in separate advice to the Minister of Commerce and Consumer Affairs (as the statutory decision-maker). This full assessment is required by section 138(1B) of the CCCFA, and will be published along with the regulations when they are gazetted. A copy of this assessment is attached to this Impact Summary as **Annex 1**.



### 3.2 Which of these options is the proposed approach?

The proposed approach is to provide a full CCCFA exemption for the REPB loans scheme, subject to specified conditions. This option would address the problem identified by relieving Kāinga Ora of unduly onerous and burdensome compliance obligations under the CCCFA, while adequately protecting the interests of debtors.

## Section 4: Impact Analysis (Proposed approach)

### 4.1 Summary table of costs and benefits

<b>Affected parties</b> <i>(identify)</i>	<b>Comment:</b> nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks	<b>Impact</b> <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts</i>
<b>Additional costs of proposed approach, compared to taking no action</b>		
Regulated parties (Kāinga Ora)	0	
Regulators	0	
Wider government	0	
Other parties	Some residual risks for borrowers – discussed below under “further information about risks to borrowers” below.	
<b>Total Monetised Cost</b>	0	
<b>Non-monetised costs</b>		Low

<b>Expected benefits of proposed approach, compared to taking no action</b>		
Regulated parties	<p>Kāinga Ora will not need to incur the costs of developing a full CCCFA compliance regime. It has not been possible to assess the total cost of establishing a CCCFA compliant loan scheme.</p> <p>However, it has been estimated that legal costs alone would be in the region of \$400,000 without an exemption, compared with an estimated \$150,000 with an exemption.</p> <p>Estimated savings:</p>	At least \$250,000
Regulators	0	
Wider government	0	
Other parties		
<b>Total Monetised Benefit</b>		At least \$250,000
<b>Non-monetised benefits</b>	Prompt establishment of the scheme	Low

## Further information about risks to borrowers

Some potential risks to borrowers as a result of the proposed exemption were considered, and determined to be a low risk.

### **Debtors enter into the agreement without understanding the terms and conditions and obligations**

The conditions attached to the exemption will require that terms and conditions for the REPB loans will be in plain language. In addition, Kāinga Ora will require borrowers to obtain independent legal advice. This mitigates the risk that debtors take on a loan under the REPB scheme without fully understanding the terms and conditions and their obligations under the scheme.

### **The credit provided is unsuitable or that repayments may cause hardship**

The proposal includes exempting Kāinga Ora from the obligation to undertake reasonable inquiries to be satisfied that the credit or finance provided under the agreement will likely meet the borrower's requirements and objectives.

The REPB loans are only available in extremely limited circumstances where Kāinga Ora is fulfilling a need for credit which commercial lenders are unable to fulfil. In particular, they are only available for seismic refit of a unit, with a maximum loan of \$250,000. Kāinga Ora will have an extensive level of engagement with eligible applicants, such as working out with the applicant their share of remediation costs to be funded by the REPB Loan and discussing with the applicant how the loan scheme will work.

In addition, the loan is only repayable on sale of a unit, the owner's death or if the owner is no longer occupying the unit. That is, the loan will be repaid using the proceeds of the sale of the property and not the debtor's income.

In addition, obligations under Part 4 of the CCCFA (enforcement and remedies), and Part 5 (reopening of oppressive credit contracts) would still apply to loans made under the REPB loans scheme, regardless of the exemption.

Obligations under the Financial Services Providers (Registration and Dispute Resolution) Act 2008 will also be met. This means that debtors will have access to a free and independent dispute resolution service in the event that they cannot resolve a complaint with Kāinga Ora.

As a result, there is little risk that the credit would be unsuitable and would negatively impact borrowers.

## 4.2 What other impacts is this approach likely to have?

No other impacts have been identified.

## Section 5: Stakeholder views

### 5.1 What do stakeholders think about the problem and the proposed solution?

Kāinga Ora as the applicant for the exemption strongly support the problem definition and proposed solution.

Commerce Commission staff have indicated informally that they do not support a full exemption, and consider that a partial exemption would be more appropriate. They have noted that Kāinga Ora is proposing to be required to comply, or partly comply, with a number of obligations in the CCCFA through conditions of the exemption. They have suggested that a partial exemption focussing on specific obligations that are burdensome to comply with would be more appropriate than a full exemption with conditions. However, the Commission has indicated that they see the choice of exemption as a policy decision for MBIE and are comfortable with MBIE seeking a “full” exemption for Kāinga Ora.

However, Kāinga Ora considers that a partial exemption of any sort would still result in an undue burden, as it would need to maintain an extensive CCCFA compliance programme to ensure continued compliance, particularly as the CCCFA has been recently amended and obligations changed.

MBIE considers that the approach of giving a full exemption is warranted in this instance, given the small size of the scheme, its social objectives and its administration by a Crown entity. Consideration was given to a partial exemption from specific CCCFA obligations, but this was not considered to be sufficient to achieve the purpose of the REPB loan scheme in a timely and cost prudent manner. Given the unique circumstances of the scheme, this exemption is not intended to create a precedent for other complete exemptions from the CCCFA.

# Section 6: Implementation and operation

## 6.1 How will the new arrangements be given effect?

The proposed approach will be given effect by regulations made under the CCCFA. Given that it is an exemption that only directly affects the regulated party that has sought it, we anticipate it will commence immediately.

# Section 7: Monitoring, evaluation and review

## 7.1 How will the impact of the new arrangements be monitored?

Only limited monitoring is planned, given the confined scope of the exemption, and the small number of loans involved. Officials will review the REPB loans scheme after it has been in operation for 12 months as to whether any concerns have arisen from the operation of the exemption.

## 7.2 When and how will the new arrangements be reviewed?

No review is intended, unless there are indications from stakeholders that concerns have arisen from the operation of the exemption.

## Annex 1: Exemption Analysis

# Residential Earthquake-Prone Buildings Loan Scheme: Kāinga Ora CCCFA exemption

Prepared by: Warren Hassett

Reviewed by: Glen Hildreth, Sally Whineray

## Background

1. In July 2017, a new Earthquake-Prone Buildings (**EPBs**) system came into effect that requires EPBs to be remediated within set timeframes to improve life safety.
2. Without substantial financial assistance, some unit owner-occupiers in Residential Earthquake-Prone Buildings (**REPBs**) (and some household unit owner-occupiers in mixed use EPBs) are likely to face financial hardship meeting their contribution to remediation costs, and may be forced to sell their home/unit. Concerns about this issue are primarily in areas of high seismic risk, such as Wellington city.
3. In order to mitigate this significant risk of hardship, a Residential Earthquake-Prone Building Financial Assistance Scheme (**the REPB loans scheme**) was proposed. The proposed form of assistance for eligible unit owners was a deferred payment loan with a below market rate of interest.
4. In January 2020, Cabinet agreed to the REPB loans scheme to help the owners of residential earthquake prone buildings undertake repairs (CBC-20-MIN-0002 refers). Budget 2019 had already appropriated \$23.3 million over four years for the Scheme. Funding appropriated includes \$10 million in capital for lending assistance, plus funding for set-up and ongoing administration costs for the loan scheme. Kāinga Ora is the delivery agent for the scheme, and because the loans scheme provides finance to consumers, it will, in the absence of any exemption, have to comply with the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**).
5. Kāinga Ora approached MBIE (Competition and Consumer Policy) to request an exemption to the CCCFA in March 2020, stating that compliance with the CCCFA would be overly burdensome for the purpose and size of the scheme, and also that the obligations do not fit well with its status as a crown entity.
6. Kāinga Ora have formally requested a full exemption be prescribed in regulations under section 138(1)(a) of the CCCFA exempting the REPB loans scheme from the CCCFA, potentially under some negotiated terms and conditions.

## EPB Scheme

7. The overall objective of the REPB loans scheme is to contribute to unit owner-occupier wellbeing by supporting unit owner-occupiers in REPBs (and household unit owner-occupiers in mixed use EPBs) in areas of high seismic risk that are facing hardship in meeting the costs of earthquake strengthening. Supporting eligible owner-occupiers with some costs will help reduce the risk of such owners being forced to sell their homes/units.
8. The scheme will also further incentivise REPB remediation within statutory timeframes under the Building Act 2004, which has life safety benefits.
9. Budget 2019 approved funding for lending assistance for affected unit owners in REPBs (and household unit owners in mixed use EPBs) as a deferred payment loan with a below market rate of interest. Because the Scheme supports the private retention of home ownership over a long period of time, an affordable loan is an appropriate form of assistance. It also avoids contention around the role of government in body corporate decisions and creating additional ongoing Crown obligations.
10. The loans will be required to be paid back upon the death of the owner, sale of the unit, or in the case that the owner no longer occupies the unit and becomes classed as an investor rather than an owner-occupier.
11. The eligibility criteria for the scheme are very strict as the scheme was designed as a “lender of last resort” where a unit owner is unable to obtain a loan from a bank because the responsible lending obligations under the CCCFA cannot be met. The purpose of the REPB loans is to provide substantial financial assistance to unit owner-occupiers in REPBs that are likely to face financial hardship meeting their contribution to remediation costs, and would otherwise be forced to sell their home/unit.
12. The relevant owner eligibility criteria for the scheme are that:
  - the unit owner must be a New Zealand Citizen; ordinarily resident in New Zealand or an overseas person allowed under the Overseas Investment Act 2005;
  - the unit owner must be an owner-occupier of that unit for the duration of the loan;
  - those applying must
    - have been declined a loan that covers the full cost of remediation from a registered bank or non-bank deposit taker supervised by the Reserve Bank of New Zealand; or
    - bank/non-bank deposit taker finance has been offered but is conditional on sale of the unit on completion of remediation works; or
    - be in circumstances where if finance were obtained, making repayments out of income would cause the owner significant financial hardship.



13. There are extensive further eligibility criteria relating to owner eligibility and unit and building eligibility, however they are not directly relevant to this exemption analysis, as they do not relate to the purpose of the CCCFA or the criteria that the Minister must consider when determining whether to proceed with an exemption.
14. The full REPB loan scheme settings can be found at:  
<https://www.building.govt.nz/managing-buildings/managing-earthquake-prone-buildings/residential-financial-assistance-scheme>

## Summary of exemption and terms of exemption

16. Kāinga Ora seek an exemption under section 138(1)(a) of the CCCFA for the Residential Earthquake Prone Building Financial Assistance Scheme, exempting loans made under the scheme from being a consumer credit contract. The exemption is sought only for the REPB loans scheme and would not apply to other similar or identical future schemes.
17. Kāinga Ora does not currently provide consumer finance and therefore has only limited obligations under the CCCFA currently.

## What type of exemption is being sought by Kāinga Ora?

18. Kāinga Ora has applied for a full exemption under s138(1)(a) of the CCCFA. Section 138(1)(a) provides that the Governor-General may, by Order-in-Council, make regulations exempting any class of credit contract from being a consumer credit contract. The regulations may provide for any terms and conditions to apply to that exemption. Kāinga Ora considers that a section 138(1)(a) exemption is appropriate for the REPB loans scheme, and the loans made under it, given the size and purpose of the scheme. In particular, Kāinga Ora notes that:

- i. The prime purpose of the CCCFA is to protect the interests of consumers in connection with consumer credit contracts. In the case of the REPB loan scheme, consumer interests will be protected by the provision of appropriate conditions in the exemption. The conditions proposed by Kāinga Ora are set out below.
- ii. Granting the exemption will not cause significant detriment to those who receive loans from the REPB loans scheme as detailed further below.

## What conditions are proposed by Kāinga Ora?

19. Kāinga Ora has proposed that the following conditions apply to the exemption:
  - i. The creditor under the REPB loans scheme is Kāinga Ora or any successor in respect of the scheme.
  - ii. The loan agreement and loan terms and conditions are in plain language, but with no equivalent requirement for the mortgage terms<sup>3</sup>.
  - iii. that Kāinga Ora will disclose the matters set out in paragraphs (a), (aa), (e), (g), (h), (i), (j), (k), (m), (n), (p), (q), (r), (t) and (u) of schedule 1 of the CCCFA in relation to the REPB loans, but only to the extent each such matter is applicable and ascertainable as at the relevant disclosure date, and as if sections 32-35 of the CCCFA apply to that disclosure.

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<sup>3</sup> If Kāinga Ora was required to use plain language mortgage documents, (in line with the responsible lending code in the CCCFA) it would be unable to use New Zealand's default mortgage terms (the ADLS mortgage terms). These are not in plain language and there would be a significant cost in drafting them in plain language. Kāinga Ora considers that these costs would not be justified for the small number of loans involved.

- iv. that Kāinga Ora will disclose the matters set out in sections 19(1)(a) to 19(1)(f) and 19(1)(h) of the CCCFA in relation to the REPB loans at least every 6 months from the date of the first advance under the relevant loan, as if sections 20-21 and 32-25 of the CCCFA apply to that disclosure<sup>4</sup>.

20. In relation to condition (iii), Schedule I of the CCCFA relates to “key information” concerning a consumer credit contract that must be made available to a debtor by a creditor. Under condition 3, a subset of the information required by Schedule 1 will be provided by Kainga Ora.

21. The key information that Kāinga Ora will provide where applicable and ascertainable is:

- Kāinga Ora’s name and address
- total of all advances made or to be made under the loan contract
- annual interest rates under the load contract
- if there is more than one rate, how each rate applies
- the period (if any) during which the interest rate is fixed
- information about how the annual interest rate is determined
- how interest is calculated, and frequency with which interest charges are debited under the loan contract
- length of any interest free period and when interest will begin to accrue
- description of the credit fees and charges including the amount payable and when it is payable
- how Kāinga Ora’s loss on full prepayment of the loan is calculated and what procedure is used
- description of any security interest that is or may be taken in connection with the loan contract
- default interest charges and fees that may be payable
- frequency with which continuing disclosure statements will be provided
- a statement to the effect that Kāinga Ora consents to receive notices or other communications from the debtor if such consent is given

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<sup>4</sup> Section 19(1)(g) of the CCCFA has been excluded from this list due to the technical challenges of producing loan statements with a “next payment” that is not a known amount or date for most of the time, and only becomes a known date once certain events (death or ceasing to be an owner occupier) occur. Depending on the exact facts, it may or may not be possible to calculate the expected repayment amount once the future repayment date is known.

# Analysis of the Kāinga Ora application

## Section 138(1)(a) of the CCCFA

22. Section 138(1)(a) of the CCCFA allows a class or type of credit contract to be exempt from the Act, subject to any terms and conditions. To date two partial exemptions have been provided under 138(1)(ab).

## Criteria for assessment

23. The statutory criteria are in place to ensure that exemptions to the CCCFA do not undermine the protection of debtors under credit contracts and that exemptions are appropriate. In addition to the statutory criteria, an additional broader net benefit examination is also appropriate.

## Statutory criteria

24. Section 138(1A) states that the Minister may only make a recommendation for regulations to be made under (1)(a) if they:

- have had regard to the purposes of the CCCFA;
- are satisfied the exemption would not cause significant detriment to debtors under credit contracts; and
- are satisfied that compliance with the consumer credit contract provisions of the CCCFA would, in the circumstances, require a creditor to comply with requirements that are unduly onerous or burdensome.

25. When making a recommendation relating to an exemption regulation, the Minister must also publish their reasons for making the regulation.

## The purposes of the CCCFA

26. Section 3(1) of the CCCFA provides that its primary purpose is the protection of the interests of consumers in relation to credit contracts, consumer leases and buy-back transactions of land.

27. Additional purposes of the Act include:

- promoting confident and informed participation in credit markets by consumers
- promoting and facilitating fair, efficient and transparent credit markets, and
- providing remedies for debtors, lessees and occupiers in relation to oppressive contracts and oppressive conduct by creditors.

28. In making an assessment of the exemption, the key consideration is whether the purposes of the CCCFA would continue to be met and promoted by the granting of the exemption.

## Protection of consumer interests

29. The interests of consumers will continue to be protected under the exemption, particularly from the types of harm that the CCCFA seeks to protect them from (e.g.

insufficient information disclosure, irresponsible lending, and unaffordable or unsuitable loans).

30. The structure of the REPB loan scheme provides protections for borrowers similar to those under the CCCFA. These include limiting establishment fees, the amount that may be lent, not pursuing negative equity, and providing for early loan repayment with no early repayment fees.

#### **Confident and informed participation in credit markets**

31. The exemption, if provided, would not negatively impact on consumer's ability to confidently participate in credit markets in an informed manner. This is because the exemption and its terms and conditions will ensure that sufficient information and protections are provided to enable consumers to participate in the market for financing remediation of REPBs. In addition, the exemption would not reduce access or ability to participate in other credit markets.

#### **Fair, efficient and transparent credit markets**

32. The exemption, if provided, would not reduce or negatively impact the continued fairness, efficiency and transparency of the market for the financing remediation of REPBs. The REPB loan scheme is a lender of last resort, providing loans to borrowers who would not otherwise be able to obtain a loan to remediate an REPB. As it addresses a "market failure" it will not interfere with the efficient working of credit markets.
33. The exemption terms and conditions would facilitate and ensure fair interactions between unit owners and Kāinga Ora especially considering the other parts of the CCCFA that would continue to apply including the debt collection requirements and the requirement not to be oppressive.
34. Transparency in the market in question as well as other credit markets will continue to be upheld with the information disclosure commitments in the exemption terms and conditions. On efficiency, the exemption would not negatively impact on the efficiency of the credit market.

#### **Consumer access to remedies for oppressive conduct and contracts**

35. The exemption, if provided, would not reduce consumer access to, or the availability of, remedies for oppressive contracts and oppressive conduct by creditors. The part of the CCCFA dealing with oppressive contracts (Part 5) is not being exempted and will continue to apply. Obligations under the Financial Services Providers (Registration and Dispute Resolution) Act 2008 will also be met. This means that debtors will have access to a free and independent dispute resolution service in the event that they cannot resolve a complaint with Kāinga Ora.

#### **Significant detriment to debtors**

36. Under section 138(1A)(b) the Minister must be satisfied the exemption would not cause significant detriment to debtors under credit contracts. The "debtors under credit contracts" referred to in s138(1A)(b) are considered to be the unit owners who obtain loans under the REPB loans scheme.

### **Risk of detriment: debtors enter into the agreement without understanding the terms and conditions and obligations**

37. The conditions attached to the exemption will require that terms and conditions for the REPB loans be in plain language. In addition, Kāinga Ora will require borrowers to obtain independent legal advice. This will mitigate the risk that debtors take on a loan under the REPB scheme without fully understanding its terms and conditions and their obligations under the scheme.

### **Risk of detriment: the credit provided is unsuitable or that repayments may cause hardship**

38. The Kāinga Ora proposal includes an exemption from the obligation for the creditor to undertake reasonable inquiries to be satisfied that:

- the credit or finance provided under the agreement will likely meet the borrower's requirements and objectives, and
- the borrower will make the repayments under the agreement without suffering substantial hardship.

39. REPB loans are only available in extremely limited circumstances where borrowers have been unable to obtain a loan from a commercial lender. In particular, they are only available for seismic refit of a unit, with a maximum loan of \$250,000. In addition, the loan is only repayable on sale of a unit, the owner's death, or if the owner is no longer occupying the unit and it is being rented out. That is, the loan will be repaid using the proceeds of the sale of the property and not the debtor's income. If the proceeds of the sale are less than the amount owing (i.e. there is negative equity), then the scheme will remit what is owed from the point that negative equity is reached.

40. Borrowers will also have the option of making voluntary repayments, with no early repayment fees, to reduce the overall amount left to repay on the loan when the unit is sold.

41. As a result, there is little risk that the credit would be unsuitable and would negatively impact debtors.

### **Compliance would be unduly onerous or burdensome**

42. Under section 138(1A)(c) the Minister must be satisfied that compliance with the consumer credit contract provisions of the Act would, in the circumstances, be unduly onerous or burdensome.

43. The EPB scheme represents a government decision that Kāinga Ora provide financial support to unit owner-occupiers to meet their share of earthquake strengthening costs where commercial lending is not available. Consumer lending is not Kāinga Ora's usual activity and Kāinga Ora is not providing the scheme with a view to commercial gain or profit. As a Crown agency, it will not be subject to the same incentives as a commercial lender.

44. The number of loans written by Kāinga Ora is expected to be small, as only \$10,000,000 is available for lending. It is estimated that no more than about 80 loans will be written. Given the size and purpose of the EPB scheme, the narrow eligibility criteria, and the

protections for borrowers in the scheme, many of the CCCFA's obligations are not appropriate and may impose significant costs on Kāinga Ora, and delay the start of the EPB scheme.

45. Examples where compliance with CCCFA obligations may be burdensome or onerous are described briefly below:

### **Personal liability of directors and senior managers**

46. The Credit Contracts Legislation Amendment Act 2019 includes a provision (which will enter into force on 1 October 2021) which provides for a due diligence requirement for directors and senior managers. Breaching this duty gives rise to the potential for personal liability for the board and senior managers of Kāinga Ora. This is not appropriate as Kāinga Ora is a Crown Entity, and its directors and senior managers would not have been appointed on the basis of having potential personal liability under the CCCFA. Imposing a due diligence requirement seems disproportionate and burdensome in the context of the REPB loans scheme and its purpose.

### **Fit and proper person test**

47. From 1 October 2021, Kāinga Ora board and senior managers will have to be certified by the Commerce Commission in order to make loans under the REPB loans scheme. The certification process will involve looking at the qualifications and experience of Kāinga Ora's board and senior managers in relation to lending. This could be problematic and unreasonable, as Kāinga Ora's usual business does not involve lending.

### **Plain language mortgage**

48. A requirement of the responsible lending code in the CCCFA is that the loan and mortgage documents be in plain language. Kāinga Ora intends that the loan documents be in plain language. However, applying the plain language requirements to the mortgage documents would prevent Kāinga Ora from using the "standard" New Zealand ADLS mortgage agreement, as the scheme is a form of mortgage. The cost of drafting a plain language mortgage agreement (estimated to be \$40,000) would be substantially more than the license fee for using the ADLS agreement (less than \$750).

### **Affordability and suitability enquiries**

49. The responsible lending code in the CCCFA requires lenders to make enquiries and assessments about the borrower's requirements and objectives, and affordability, prior to making a loan. This involves extensive enquiries into the borrower's income and expenditure. However, these seem inappropriate in the case of the REPB loans scheme, where the loans must be used for a specific purpose (remediation of a unit in an REPB) and therefore will meet the borrower's needs. Further, the loans only become payable when the unit is sold, the borrower dies, or the borrower ceases to occupy it. This means that the borrower will not have to repay the loan out of their income.

### **Disclosure**

50. The extensive disclosure obligations in the CCCFA would require Kāinga Ora to develop appropriate policies and procedures to meet requirements that may occur but are unlikely (such as request disclosure). This would be costly and onerous given the small

number of loans to be made. To the extent that disclosure obligations are important in the circumstances, they will be provided for in the conditions for the exemption.

### Cost justification of fees

51. The CCCFA contains strict requirements for cost justification of fees. Under provisions entering into force from 1 October 2021, Kāinga Ora would be required to keep records of the justification of the establishment fee.
52. The fees charged by Kāinga Ora for loans under the scheme are set at half the actual cost of establishing the loan, with a maximum of \$500. However, keeping records of how the fee was calculated would be costly, compared with the likely amount recovered from the establishment fee (a maximum of \$40,000 if there are 80 loans).

### Is partial or full exemption justified?

53. The REPB loans scheme provides for loans to unit owners in limited circumstances, with strict criteria for eligibility for the loans. The REPB loans scheme addresses a “market failure” by providing loans to unit owners who do not qualify for commercial loans. In the absence of something like the REPB loans scheme, affected unit owners may be forced to sell their units.
54. Given the amount available to be lent, the number of loans is small (estimated to be no more than 80). The loans will be made available through Kāinga Ora and will not form its core business, and it is not otherwise involved in consumer lending.
55. There are two possible types of CCCFA exemption relevant to the REPB loans scheme:
  - An exemption under s138(1)(a) of the CCCFA (a “full” exemption)
  - An exemption under s138(1)(ab) of the CCCFA (a “partial” exemption)
56. Both exemptions can be made subject to terms and conditions. Note that the CCCFA does not use the terms “full” and “partial” exemption.
57. If a “full” exemption is granted under s138(1)(a) for the REPB loans scheme, then loans made under the scheme would not be consumer credit contracts and therefore not subject to any of the provisions in Parts 1A and 2 of the CCCFA. In this case, Kāinga Ora has proposed to apply a small subset of the provisions of Parts 1A and 2 to the REPB loans, although there is no requirement in s138(1)(a) for the terms or conditions of the exemption to include application of any provisions of the CCCFA.
58. If a “partial” exemption is granted under s138(1)(ab), loans made under the REPB loans scheme would still be consumer credit contracts for the purposes of the CCCFA. The loans would be subject to all of the provisions of the CCCFA except for those provisions of the CCCFA specified in the exemption regulations.
59. A “full” exemption is more appropriate where the intention is that the loans be exempted from most or all of the provisions of Parts 1A and 2 of the CCCFA. It is a form of “opt in”



provision to the extent that any terms and conditions are consistent with some provisions of Parts 1A and 2.

60. A “partial” exemption is more appropriate where the intention is that nearly all of the provisions of the CCCFA should apply to a credit contract, with the contract being exempted only from a small subset of the provisions in the CCCFA. It is essentially an “opt out” provision.
61. In this case Kāinga Ora considers that ensuring compliance of the REPB loans scheme with most of the provisions of Parts 1A and 2 of the CCCFA would be unduly onerous and disproportionate given the nature of the loans scheme, and the small number of loans likely to be made. The terms and conditions they have proposed are those where compliance is considered by Kāinga Ora to be proportionate, and which also ensure that the statutory requirements for an exemption are met. On this basis, a “full” exemption under s138(1)(a) is most appropriate.
62. On this basis, MBIE believes that loans made under the REPB loans scheme justifies a full exemption from being consumer credit contracts under section 138(1)(a) of the CCCFA.

### **Broader net benefit**

63. The overall benefits of the exemption if provided, while unquantified, would appear to be substantial. These include significantly reduced CCCFA compliance costs as well as faster availability of loans under the EPB scheme. Delays in making loans available may result in some unit owners who might otherwise be eligible for loans under the scheme might be forced to sell their unit, defeating the object of introducing the scheme.
64. Given MBIE’s conclusions above about there being no significant detriment to debtors from the exemption, the costs of the exemption also appear to be minimal. We therefore consider that the exemption would have a substantial net benefit, so long as it is granted under the conditions proposed.

### **Recommendation and conclusion**

65. MBIE recommends that the REPB loans scheme be granted a full exemption under section 138(1)(a) of the CCCFA subject to the conditions proposed by Kāinga Ora. This is based on the following:
- Requiring full compliance by Kāinga Ora would impose significant costs on Kāinga Ora that would be disproportionate in relation to the number of loans that are likely to be made.
  - The time required for Kāinga Ora to develop the processes and procedures required for CCCFA compliance would be likely to significantly delay the start of the REPB loans scheme. Delays in the start of the scheme may mean that some unit owners, who might otherwise be eligible for loans under the scheme may be forced to sell their unit, defeating the object of introducing the scheme.

- Given the protections included in the terms and conditions, it is unlikely that borrowers will experience detriment and so the purpose of the CCCFA of protecting the interests of consumers will continue to be met with the exemption given.

# Appendix 1: Kāinga Ora’s examples of CCCFA provisions unduly burdensome or onerous to comply with

The table below sets out Kāinga Ora’s views on the unduly burdensome characteristics of certain provisions of the CCCFA, when applied to the EPB scheme.

CCCFA reference	CCCFA requirement	Reason provisions would be unduly burdensome/alternative approach proposed	Means of addressing underlying issue (where applicable)
<p><b>Section 9C(3)(a)</b></p> <p><i>Inquiries before entering into the agreement</i></p>	<p>Creditors are required to make reasonable inquiries before entering an agreement to be satisfied that it is likely that the credit will meet the borrower’s requirements and objectives and that the borrower will make the payments under the agreement without suffering substantial hardship.</p>	<p>These inquiries are extensive and often inappropriate given the nature of the REPB loan scheme. For example, they are likely to require extensive inquiries in relation to the borrower’s income and expenditure (along with verification and testing of that income and expenditure), when the loans will be repaid using the proceeds of the sale of the property and not income.</p> <p>The REPB loans are only available in an extremely limited situation where Kāinga Ora is stepping in to fill a need that commercial lenders are unable to fill, in a situation where it is for everyone’s benefit that the earthquake-prone buildings are strengthened so as to be safe for the public to be around.</p>	<p>Not relevant or necessary in the context of the REPB loans scheme.</p>
<p><b>Section 9C(3)(b)</b></p> <p><i>Assist the borrower to reach an informed decision <u>before</u> entering into the loan</i></p>	<p>Creditors are required to assist a borrower to reach an informed decision as to whether or not to enter the loan.</p>	<p>Kāinga Ora will be required to make extensive explanations and provide information to borrowers to help them make informed decisions. These obligations would be scaled up under the responsible lending code on the basis that the borrowers are “vulnerable” (as they are likely to be under significant pressure to obtain credit) and that the REPB loans are “reverse equity mortgages”. This will be the case even though Kāinga Ora will require borrowers to have independent legal advice and the lawyers will also make those explanations.</p>	<p>Kāinga Ora’s requirement for borrowers to obtain independent legal advice means that this requirement is not relevant or necessary in the context of the REPB loans scheme.</p>

CCCFA reference	CCCFA requirement	Reason provisions would be unduly burdensome/alternative approach proposed	Means of addressing underlying issue (where applicable)
<p><b>Section 9C(3)(b)(ii)</b></p> <p><i>Assist the borrower to reach an informed decision <u>before</u> entering into the loan</i></p>	<p>ensure that the terms of the loan agreement are expressed in plain language in a clear, concise and intelligible manner.</p>	<p>One of the responsible lending obligations is that the loan and mortgage documents are in plain language. This would prevent Kāinga Ora using New Zealand's usual default mortgage terms, known as the ADLS mortgage terms. Unfortunately, the ADLS mortgage terms are not in plain language and, as a result, Kāinga Ora would need to incur the significant cost of drafting a plain language mortgage despite the small number of loans. In contrast, the licence fee for the ADLS mortgage terms is de minimus – expected to be less than \$750 for 80 loans. It is Kāinga Ora's intention to have a plain language loan agreement and terms and conditions, as these will be prepared specifically for the REPB loans in any event.</p>	<p>Proposed conditions for the exemption will require loan conditions (apart from the mortgage agreement to be in plain language). The borrower should also obtain their own legal advice as part of their due diligence.</p>
<p><b>Part 2, subpart 2</b> <i>Required disclosure</i></p>	<p>Subpart 2 sets out the information that creditors must disclose to the debtor.</p>	<p>The need to meet all of the disclosure requirements (and to have policies and procedures to meet ones that may occur but are unlikely, such as request disclosure) would be onerous given the number of REPB loans to be made.</p>	<p>To the extent that any disclosure is considered important, this will be dealt with in the conditions of the exemption.</p>
<p><b>Section 19(1)(g)</b></p> <p><i>Content of Continuing disclosure statement</i></p>	<p>Every continuing disclosure statement must contain as much of certain prescribed information as is applicable to the consumer credit contract, including the amount and the time for payment of the next payment that must be made by the debtor under the contract.</p>	<p>Section 19(1)(g) of the CCCFA has been excluded due to the technical challenges of producing loan statements with a "next payment" that is not a known amount or date for most of the time, and only becomes a known date once certain events (sale of the unit, death or ceasing to be an owner occupier) occur. Depending on the exact facts, it may or may not be possible to calculate the expected repayment amount once the future repayment date is known.</p>	<p>Not relevant or necessary in the context of the EPB scheme.</p>
<p><b>Section 41A</b> <i>Records and reviews about how fees are calculated (to enter into force 1 October 2020)</i></p>	<p>The creditor under a consumer credit contract must keep records about how the creditor calculated each credit fee and default fee for the purposes of section 41.</p>	<p>The CCCFA contains strict requirements for the cost justification of fees. Under the responsible lending code and from 1 October 2021, Kāinga Ora will be required to keep records of the justification of the establishment fee. However, the cost of going through that justification process is very high,</p> <p>given the likely amount to be recovered by that fee (a</p>	

CCCFA reference	CCCFA requirement	Reason provisions would be unduly burdensome/alternative approach proposed	Means of addressing underlying issue (where applicable)
		maximum of \$40,000 if there are 80 loans).	
<p><b>Section 59B(1)</b> <i>Directors and senior managers to exercise due diligence</i> (to enter into force on 1 October 2020)</p>	<p>Every director and senior manager of a creditor under a consumer credit contract must exercise due diligence to ensure that the creditor complies with its duties and obligations under this Act.</p>	<p>While Kāinga Ora should and will take sufficient care when establishing the REPB loans scheme, the subsequent potential liability imposed on directors and senior managers through section 48 of the Credit Contracts Legislation Amendment</p> <p>Act 2019 is not appropriate in these circumstances as Kāinga Ora is a Crown entity and its directors and senior managers would not have been appointed on the basis of having potential personal liability under the CCCFA.</p>	<p>Not relevant or necessary in the context of the EPB scheme.</p>
<p><b>Part 5A</b> (to enter into force on 1 October 2020)</p>	<p>A person who is a creditor under a consumer credit contract must hold a certification from the Commerce Commission that they are a fit and proper person to hold their position.</p>	<p>From 1 October 2021 Kāinga Ora will need to be hold a certification from the Commerce Commission in order to continue making the REPB loans. In order to be certified, Kāinga Ora's board and senior managers would need to pass fit and proper persons tests which, among other things, will look at their qualifications and experience in relation to lending businesses. Kāinga Ora expects this to be problematic, given that its usual business does not involve lending.</p>	<p>Not relevant or necessary in the context of the EPB scheme.</p>