

Updated draft Responsible Lending Code 2020

Commentary and request for submissions

December 2020

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The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by 5pm on **15 January 2021**.

Your submission may respond to any or all of these issues. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission by:

- sending your submission as a Microsoft Word document to consumer@mbie.govt.nz.
- mailing your submission to:

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

Please direct any questions that you have in relation to the submissions process to consumer@mbie.govt.nz.

Use of information

The information provided in submissions will be used to inform MBIE's advice to Ministers on updating the Responsible Lending Code. We may contact submitters directly if we require clarification of any matters in submissions.

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Contents

- 1 Introduction 6**
 - Context 6
 - Purpose of this document..... 7
 - The draft updated Code 7
 - Conventions in the Code 7
 - Presentation of consultation draft of updated Code 7
 - Process and timeline 7

- 2 Overview of proposed changes to the Code 8**
 - Chapter 3 – Advertising..... 8
 - Chapter 4 – Inquiries into and assessment of borrowers’ requirements and objectives (Suitability) 8
 - Chapter 5 – Inquiries into and assessment of substantial hardship (Affordability)..... 9
 - Chapter 7 – Assisting borrowers to make an informed decision..... 9
 - Chapter 12 – Default and other problems 10
 - Terminology used in the revised Chapter 12 11
 - Specific questions in relation to Chapter 12 12
 - Reference to vulnerable consumers in the Glossary..... 13

1 Introduction

Context

1. Since 2015, lenders have been required to comply with lender responsibility principles set out in the Credit Contracts and Consumer Finance Act 2003 (**the Act**).
2. The Responsible Lending Code was first introduced in 2015 to provide detailed guidance on how lenders can comply with these high-level lender responsibility principles in practice. The Code provides non-binding guidance as lenders can also meet the responsibility principles in other ways. The guidance has 'evidentiary' status, meaning that compliance with the Code is considered evidence of compliance with the Act (in contrast to being deemed to be compliant).
3. In December 2019, the Credit Contracts Legislation Amendment Act (**the Amendment Act**) amended the Act with the aim of reducing non-compliance (irresponsible and predatory lending) and consumer harm. The Amendment Act also provided for the creation of regulations to support a range of new requirements.
4. Regulations have now been made that are largely based on the non-binding guidance that was previously in the Code. In August 2020, the [*Credit Contracts and Consumer Finance Amendment Regulations 2020*](#) were made. This first set of regulations included regulations relating to credit advertising standards that were largely in the Code. In November 2020, the remaining regulations were made. These are the [*Credit Contracts and Consumer Finance \(Lender Inquiries into Suitability and Affordability\) Amendment Regulations 2020*](#).
5. The Code therefore requires an update following the changes by the Amendment Act and the codification of substantial parts of the existing guidance in regulations.
6. Chapter 12 of the Code has also undergone a detailed review, in light of issues identified by officials and lenders during the COVID-19 disruption earlier this year. This chapter provides guidance for lenders when dealing with borrowers who are or may be having repayment difficulties. The draft updates to the chapter also permanently incorporate elements of the temporary Addendum to the Responsible Lending Code issued in June 2020.

Purpose of this document

7. MBIE is seeking feedback on the content of the updated draft Responsible Lending Code. This document provides a commentary to provide submitters with some context on the proposed update and to ask specific questions.

The draft updated Code

Conventions in the Code

8. In keeping with its evidentiary status, the Code uses a number of conventions which are relevant to how it is applied.
 - 'Must' is only used when referring to statutory obligations in an Act or regulations.
 - 'Should' indicates actions that a lender needs to take to show that it is compliant with the Code and therefore to use as evidence of compliance with the Act and regulations.
9. The Code also uses the word 'may' in a number of ways that differ depending on the context. In some cases, this indicates an example of behaviour which would be evidence of compliance, but lenders could show compliance with the Code without this behaviour. 'May' is also used in some cases to provide exceptions from Code requirements.

Presentation of consultation draft of updated Code

10. Due to the extensive changes made to certain chapters of the updated Code, MBIE has not provided a tracked version of the Code as part of the consultation draft. Submitters may wish to refer to the current guidance to compare changes made in the updated Code.
11. Where the consultation draft includes a provision from the existing Code, we generally expect that it represents an established practice that lenders are already complying with. Given that the focus of this update is to take account of the Amendment Act and associated regulations, a strong case is required to make other changes.

Process and timeline

12. We welcome feedback by 5pm on Friday, 15 January 2021.
13. Once submissions have been analysed, the updated Code will be finalised and published in February 2021.
14. The bulk of the updated Code will come into force on 1 October 2021 along with the remaining changes in the Credit Contracts Legislation Amendment Act 2019 and the new regulations.
15. We are seeking submissions on the appropriate commencement date(s) for changes to Chapter 12.

2 Overview of proposed changes to the Code

16. Previously the Code provided detailed guidance for lenders on ways to meet their lender responsibility principles in the Act. Given the shift to prescription in the regulations, the updated chapters 4 and 5 of the Code provide specific guidance on areas where lenders have advised there is a need for further clarity on key concepts in the regulations.
17. The bulk of the changes made to the Code relate to chapter 3 on advertising, chapters 4 and 5 on affordability and suitability, and chapter 12 relating to repayment difficulties.
18. The remaining chapters have minor changes only, and some chapters have remained unchanged in the proposed updated draft (for example, chapters 13 and 14).

Chapter 3 – Advertising

19. Most of this chapter has been removed as the existing guidance is now largely prescribed in the [***Credit Contracts and Consumer Finance Amendment Regulations 2020***](#).

Chapter 4 – Inquiries into and assessment of borrowers' requirements and objectives (Suitability)

20. Chapters 4 and 5 have undergone significant changes as the [***Credit Contracts and Consumer Finance \(Lender Inquiries into Suitability and Affordability\) Amendment Regulations 2020***](#) have largely prescribed the requirements for lenders in this area. The Code provides for specific guidance on aspects of the regulations where lenders have directed that more guidance is needed.
21. Chapter 4 provides guidance around assessing whether a consumer credit contract is suitable for the borrower's objectives and requirements. Lenders requested guidance on how to make inquiries in the following specific situations:
 - a. when there may be a range of products that meet the borrower's requirements and objectives
 - b. when a material change is made to the original agreement.

22. The Code also provides guidance on lenders' new statutory responsibilities to keep records of the inquiries they have made and how they reached their lending decision.

Chapter 5 – Inquiries into and assessment of substantial hardship (Affordability)

23. This chapter provides guidance on the inquiries that lenders must make to assess whether a loan is affordable for a borrower (specifically, whether the lender is satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship). As outlined above, the existing guidance in this chapter is now largely prescribed under regulations. This chapter provides guidance on specific areas of the regulations where lenders have requested further direction.
24. The regulations require the lender to ensure that the borrower has a reasonable surplus, or else that adequate buffers or adjustments have been incorporated into income and expenses. This is to address the risk that a borrower's likely income may be overestimated or expenses underestimated, or that the borrower needs to incur other expenses. Lenders on the Code Advisory Group were particularly interested in Code guidance on how they can assess the adequacy of their buffers and adjustments to comply with the regulations.
25. The Code Advisory Group members also requested guidance on how to assess the affordability of a credit contract where the borrower may share some expenses with others such as a spouse.
26. The draft updated Code also sets out how lenders can meet their obligations under the section 9CA of the Amendment Act which requires lenders to keep records of their inquiries and the results of these inquiries.

Chapter 7 – Assisting borrowers to make an informed decision

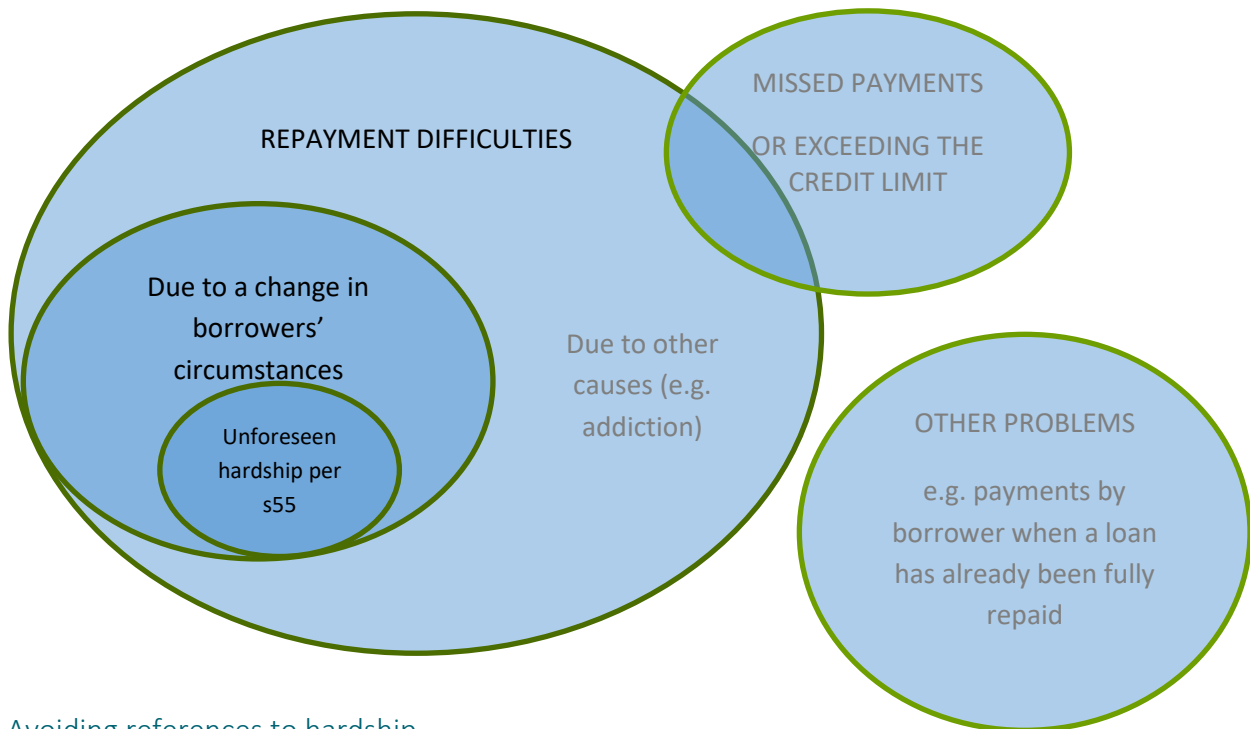
27. The Amendment Act introduced a provision requiring lenders to take reasonable steps to offer the borrower information about the agreement in another language if:
 - a. the lender has advertised the product in that language in the preceding 6 months, and
 - b. if this is necessary to ensure the borrower can reach an informed decision.
28. This chapter in the Code now provides some draft guidance on this obligation. As part of this guidance, we have set out that lenders should provide opportunities for borrowers to opt in to receive information in the advertising language. The guidance also specifies that lenders should provide key information about the loan in the advertising language if the borrower wishes to receive information in that language.

Chapter 12 – Default and other problems

29. The CCCFA provides a statutory process which can be used in cases of unforeseen hardship, and this is laid out in sections 55 to 59A of the Act. However, during COVID-19 it became evident that the statutory processes and the Code guidance were not adapted to considering relief to borrowers in situations where there is significant uncertainty. In response to this, the 'Updated addendum to the Responsible Lending Code: COVID-19' was introduced. This additional guidance was approved on a temporary basis and expires in March 2021. The Commerce Commission also issued urgent guidance.
30. The objective when revising this chapter was to address a range of issues identified by officials and by lenders, during the consumer lending sectors' response to COVID-19 disruption earlier this year. These are:
 - a. To incorporate elements of the temporary 'Updated addendum to the Responsible Lending Code: COVID-19' which are relevant on an ongoing basis (including setting out expectations for how section 9C(3)(a)(ii) applies when variations are given effect by issuing replacement contracts).
 - b. To elaborate on aspects of the application of the statutory hardship process in the CCCFA, in light of recent Commerce Commission guidance making explicit that this is a 'floor' rather than an exclusive pathway.
 - c. To more fully reflect existing good processes within consumer lenders, when dealing with borrowers in financial difficulty (including before and after a borrower's application for relief is considered).
 - d. To explicitly recognise that some borrowers require information and assistance to be aware of or apply for relief, or to access the statutory hardship process in the CCCFA.

Terminology used in the revised Chapter 12

31. The current Chapter refers to repayment difficulties, missed payments, unforeseen hardship applications, 'other repayment difficulties' and 'other problems'. We have retained these key concepts. The diagram below illustrates the relationships between them.



Avoiding references to hardship

32. Where relevant, the Code refers to 'engaging with the lender to resolve repayment issues' or 'have a conversation about what the borrower can afford' rather than referring specifically to 'hardship'. This is for reasons of plain language, but also because:
- Staff at a number of lenders we interviewed noted that some borrowers are reluctant to be referred to as being 'in hardship' and in some cases resist applying for repayment relief.
 - All lenders have the discretion, where appropriate in the circumstances and where it is commercially reasonable, to consider offering relief even where a person's repayment difficulties are not the result of 'unforeseen hardship' as defined in the CCCFA.
 - This more open language is consistent with the Electricity Authority's draft Customer Care Guidelines¹.

¹ The draft Guidelines were publically consulted on in October-November 2020 and can be found here: <https://www.ea.govt.nz/development/work-programme/operational-efficiencies/medically-dependent-consumer-and-vulnerable-consumer-guidelines/feedback-on-a-proposed-addendum-applying-to-the-guideline-on-arrangements-to-assist-vulnerable-consumers-and-the-guideline-on-arrangements-to-assist-medically-dependent-consumers/#c18726>.

Specific questions in relation to Chapter 12

Informing guarantors regarding variations to contracts

33. The draft Code provides as follows:

When a contract is varied to provide the borrower with relief, the total amount owing on the loan may increase. Lenders should set out the details of the variation in a way that makes it easy for the borrower to understand the effect the relief has on their loan (paragraph 12.27).

34. Potentially, this requirement to set out the details of the variation could also extend to communicating the variation information to the guarantor, in cases where the total amount owing increases.

Question 1: What is the current practice of lenders, in relation to informing guarantors about variations, and how are privacy considerations managed?

Question 2: In your view, how should the Code address the issue of informing the guarantor in these circumstances (if at all)?

Lenders proactively suggesting that borrowers in repayment difficulty have loan repayments deducted from income

35. Consumer advocates have noted that in some cases, lenders suggest or request that borrowers address repayment difficulties by arranging for loan repayments to be deducted directly from their benefit. This type of arrangement is done with the borrower's consent and is different to an attachment order issued by a Court.

36. The concern is that this removes the borrower's ability to prioritise spending on essential living costs, and also fails to assist the borrower in exercising agency and using financial capability skills.

37. Moving to direct deductions from any source of income as a way of addressing repayment difficulties is likely to be inappropriate, in the absence of other inquiries by the lender regarding the cause and level of the borrower's repayment difficulties.

38. Meanwhile, if a customer can afford to make repayments from their benefit or other income, and also meet their essential living costs and other financial obligations, then it may well be in their financial interest to use this method of repaying the debt.

39. In the section 'Specific practices relating to other problems or to repayment difficulties' we have proposed the inclusion of the following paragraph:

where a borrower is having repayment difficulties, a lender should not request or suggest that borrowers make loan repayments direct from their benefit or other income unless the lender has first determined that the repayments are at a level which enables the borrower in their current circumstances to reasonably expect to be able to discharge their obligations while also meeting necessities and other financial commitments (paragraph 12.41(e)).

Question 3: In your view, does the proposed addition appropriately balance the considerations in these situations? If not, please explain your reasoning.

Lead time for implementation

40. Some elements of the chapter reflect existing general practice, and others will require process changes and staff training for many lenders, before they can be implemented. We note that lenders have significant work to do to prepare for implementation of the Amendment Act by 1 October 2021. Meanwhile, the addendum to the Responsible Lending Code expires on 30 March 2021. We also note that
- the updated Chapter 12 does not have to come into force at the same time as changes to the Code in response to regulations, and
 - the whole Chapter need not come into force at the same time, as some elements stand alone and can commence separately from the broader Chapter.

Question 4: In your view, when should the new Chapter 12 (as updated in light of submissions) come into force, to ensure lenders and borrowers have clear guidance around the management of repayment difficulties, and to allow lenders sufficient time for implementation?

Question 5: In your view, are there any elements of Chapter 12 which should come in more urgently than others?

41. Potential dates range from as soon as possible after the Code is made (i.e. 28 days after notice of the Code's publication is announced in the Gazette), to 1 October 2021 (at the same time as the regulations and other chapters of the Code), or some later date.
42. Feedback from members of the Code Advisory Group has been that the elements of the Chapter which may require time-intensive process and/or systems changes for some lenders may include:
- a. In relation to lender inquiries into repayment difficulties: the following sub-paragraph: "Where relevant and in cases where borrower may be eligible to benefit, a lender should check its records, to establish whether the lender has previously provided any credit-related insurance or repayment waiver to the borrower" (paragraph 12.14).
 - b. The section in relation to monitoring variations (paragraph 12.32).
 - c. The section in relation to suspending direct marketing of credit while a borrower has sought repayment relief (paragraph 12.33).
 - d. The section on persistent debt (paragraphs 12.44 and 12.45).

Reference to vulnerable consumers in the Glossary

43. The Glossary has been updated with a reference to the concept of customer vulnerability more broadly. The purpose of this addition is to provide context for the Code's definition of vulnerable borrower and vulnerable guarantor. The wording regarding customer vulnerability is the same as that used by the Financial Markets Authority in its guidance materials.