



## COVERSHEET

<b>Minister</b>	Hon Dr David Clark	<b>Portfolio</b>	Commerce and Consumer Affairs
<b>Title of Cabinet paper</b>	Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020	<b>Date to be published</b>	14 December 2020

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
14 December 2020	<i>Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020</i>	<i>Office of the Minister of Commerce and Consumer Affairs</i>
14 December 2020	<i>CBC-20-MIN-0076</i>	<i>Cabinet Business Committee</i>

### Information redacted

### YES / NO

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**In Confidence**

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Business Committee

**Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020**

**Proposal**

- 1 This paper seeks authorisation to:
  - 1.1. submit to the Executive Council the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020;
  - 1.2. consult on an updated Responsible Lending Code to provide non-binding guidance on the attached regulations (and other changes to lender responsibilities under the Credit Contracts Legislation Amendment Act 2019).

**Executive Summary**

- 2 In December 2019, the Credit Contracts Legislation Amendment Act 2019 (the Amendment Act) was passed which made significant changes to strengthen consumer lending laws in New Zealand. The Amendment Act also provided for the creation of regulations to support a range of new requirements introduced by that legislation.
- 3 The attached regulations support the Amendment Act and implement the remaining portion of the previous Government's decision in September 2018 to develop prescriptive, binding requirements around affordability, suitability, credit advertising standards and debt collection disclosure [DEV-18-MIN-0204]. The first portion of these regulations were made in August 2020, and covered credit advertising standards and debt collection disclosure. The attached regulations cover the remaining matters.
- 4 Lenders have responsibilities under the Credit Contracts and Consumer Finance Act 2003 (the Act) to take steps to ensure that consumer credit contracts they enter into with borrowers are likely to be affordable and suitable. The purpose of the regulations is to address concerns about non-compliance with these obligations and resulting unaffordable and unsuitable lending.
- 5 The regulations clarify the minimum steps that must be taken by lenders to assess that loans are likely to be affordable and suitable for borrowers. This will improve compliance and make the lender responsibilities easier to enforce by the Commerce Commission and borrowers. The practices prescribed by the regulations are either already recommended in the (non-binding) Responsible Lending Code or intended to be consistent with existing good practice in the industry.

- 6 I am also seeking approval to consult on an updated Responsible Lending Code, which will provide guidance on the attached regulations and other changes to lender responsibilities under the Amendment Act.
- 7 The attached regulations and the updated Responsible Lending Code will come into force on 1 October 2021 along with the bulk of the remaining changes made by the Amendment Act.

## Background

- 8 New Zealand has one of the highest household debt levels in the world at 94 per cent of GDP. In 2019, around 18 per cent of consumer borrowers reported that repayment difficulties on their loans had a moderate to severe negative impact on their everyday life.
- 9 In addition to financial impacts, debt problems have serious detrimental impacts on health and wellbeing. Further, families in financial difficulty commonly seek additional credit to meet short-term needs, even if they know repayments are unlikely to be affordable in the medium-long term.
- 10 In December 2019, the Credit Contracts Legislation Amendment Act (the Amendment Act) amended the Credit Contracts and Consumer Finance Act 2003 (the Act) with the aim of reducing irresponsible and predatory lending and resulting consumer harm. The Amendment Act also provided for the creation of regulations to support a range of new requirements introduced by the Act.
- 11 In August 2020, the first portion of the regulations were made relating to credit advertising standards, debt collection disclosure, variation disclosure, disclosure of information about dispute resolution and financial mentoring services, and how the due diligence duty of directors and senior managers applies to securitisation, covered bond and similar arrangements.
- 12 The Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 (the Regulations) cover the remaining portion: affordability and suitability. In addition to the exposure draft which was released in November 2019, two further revised drafts were circulated for targeted consultation with the industry. The Regulations have been through a thorough consultation process to ensure they reflect good practice and are practical for the industry.
- 13 The Responsible Lending Code (the Code) also requires an update for two reasons. The Regulations now prescribe much of the content that is in the current non-binding Code. Further, problems have been identified with the content on how lenders should deal with unforeseen hardship on the part of borrowers as a result of the economic impact of COVID-19.

## Affordability and Suitability Regulations

- 14 Lenders are required to comply with lender responsibilities in the Act. These include that a lender must make reasonable inquiries, before entering into a consumer credit contract, so as to be satisfied that it is likely that:

- 14.1. the credit or finance provided under the agreement will meet the borrower's requirements and objectives ("suitability"); and
  - 14.2. the borrower will make the payments under the agreement without suffering substantial hardship ("affordability").
- 15 These requirements to check affordability and suitability apply to all consumer credit contracts, including short-term high-cost loans, other personal loans, credit cards, motor vehicle loans and home loans. They do not extend to loans to businesses or for business purposes.
- 16 The Regulations set out a non-exhaustive list of minimum inquiries that must be made (as part of the 'reasonable inquiries' required by the Act) to assess whether a loan is affordable and suitable to meet the objectives and requirements of the borrower. The mandated inquiries are 'non-exhaustive' in the sense that there may be other inquiries required by the Act that are not specified in the Regulations.
- 17 The Regulations include specific requirements that lenders must undertake which are summarised below. These requirements are based on guidance currently in the Responsible Lending Code, with additional detail added to reflect existing good practice or to address key compliance issues.

*Suitability inquiries*

- 18 The Regulations specify aspects of the borrower's requirements and objectives that lenders must inquire into as part of its responsibility to determine the suitability of consumer credit contracts. These aspects include:
- 18.1. the amount of credit the borrower is seeking;
  - 18.2. the borrower's purpose for the credit;
  - 18.3. the term of the credit the borrower wants;
  - 18.4. if lump sum payments are required, whether the borrower prefers them to regular payments;
  - 18.5. if the credit contract includes 'add-ons' such as repayment waivers, extended warranties or credit-related insurance, whether the borrower needs these add-ons and accepts the additional costs;
  - 18.6. if the credit is for refinancing, whether the borrower accepts any additional interest and fees they may incur; and
  - 18.7. if the credit is for a reverse mortgage, considering the borrower's future needs.
- 19 After making these inquiries, a lender is then required by the Act to satisfy themselves that the credit or finance provided will meet the borrower's requirements and objectives.

*Affordability inquiries*

- 20 The Regulations provide more detail about how lenders must meet their obligation to assess the affordability of consumer credit contracts.

- 21 In most cases, the Regulations require lenders to estimate the borrower's likely income and expenses. The lender must show that the borrower's income exceeds their expenses (including payments under the new loan) and makes an allowance for error (e.g. overestimation of income or underestimation of expenses).
- 22 An income and expenses assessment is not required if:
- 22.1. initial inquiries show that it is obvious that the borrower will be able to make payments under the agreement;
  - 22.2. the borrower will not rely on income to make the payments (e.g. the borrower will pay off the loan using the sale of an asset); or
  - 22.3. the loan does not advance any significant new credit (e.g. it is a restructuring of existing obligations to respond to a hardship application from the borrower)
- 23 The borrower's likely income and expenses are estimated by collecting information from the borrower (or records that the lender holds about the borrower) and then conducting further checks or adjustments on that information to help ensure that the information is complete and the estimates are robust.
- 24 To assess income, lenders can use recent and reliable records that they have on file which they can confirm with the borrower, or otherwise ask the borrower about their income and verify based on evidence (such as pay slips).
- 25 For expenses, lenders can ask the borrower, use their existing records, or determine the borrower's expenses from bank transaction records. Lenders will need to make further inquiries into the borrower's financial commitments by obtaining a credit report, or (if the borrower is an existing customer) asking the borrower about commitments they've taken on since they last received credit. If there is a risk that expenses have been missed or underestimated, lenders have a choice about whether they verify expenses (e.g. through bank account transactions, or a copy of a contract) or use a statistical benchmark.

### **Impact of Regulations on consumer lending**

- 26 The Regulations are based on current guidance in the Code, as well as existing good practice by consumer lenders which address key compliance areas. The objective has been to avoid creating significant new compliance costs for already responsible lenders.
- 27 However, under the existing principles-based regulation there is a very wide range of practice and behaviours which may or may not be considered 'compliant'. Therefore, while current regulation has significant flexibility as to how inquiries are undertaken, only a minority of consumer lenders currently do all of the prescribed steps all of the time.
- 28 Broadly, the impact of the Regulations will be that most lenders will be making moderate or small adjustments and some lenders will be making significant ones. These changes are likely to be in three main areas:

- 28.1. Some finance companies are likely to make more use of statistical benchmarks to ensure that the living expenses estimates provided by borrowers are realistic.
  - 28.2. A range of banks, credit unions and finance companies are likely to verify a wider range of expenses. For example, two major banks have indicated they are investing in software to automate detailed analysis of transaction records.
  - 28.3. There may be increased processing time for borrowers (most lenders do not currently re-check expense and income information before advancing further credit or increasing a credit limit).
- 29 While the Regulations do involve cost to lenders, I believe this is an appropriate trade-off to ensure that loans are consistently made on the basis of robust assessments, and to prevent harm caused by unaffordable loans. This will be particularly important at a time when many potential borrowers have been, or are likely to be, financially impacted by the economic impacts of COVID-19.
- 30 The prescriptive nature of the Regulations will make it much easier and more efficient to identify non-compliance, and for the Commerce Commission to carry out enforcement. This should boost compliance significantly across the consumer lending sector.

### **Updated Responsible Lending Code for consultation**

- 31 Following the making of Regulations, I propose to consult publicly on an updated Responsible Lending Code. The Code provides non-binding guidance on the Regulations and other changes to lender responsibilities under the Amendment Act.
- 32 An updated Code is being developed in consultation with the Code Advisory Group, which is comprised of members from the industry, consumer advocates, academics and the Commerce Commission. Once the Regulations are made, the draft updated Code can be finalised for my consideration ahead of public consultation.
- 33 The intention is to consult on the Code from early December until mid-January 2021. Officials will then finalise the Code, after taking on board submissions, with a view to have a final Code approved in February 2021.

### **Consultation**

#### *Draft regulations*

- 34 The policy and drafting of the Regulations have been extensively engaged and consulted upon. Following research and workshops to develop the policy direction for the Regulations, an exposure draft was publicly released for consultation in November 2019. A further two drafts of the attached regulations were circulated to submitters for targeted consultation. These submitters were comprised mostly of the finance industry including banks and non-bank lenders, along with consumer advocates.

- 35 The Commerce Commission, Department of Prime Minister and Cabinet, Treasury and Reserve Bank of New Zealand have been consulted on the near-final regulations.

### **Commencement of regulations and 28-day rule**

- 36 The proposed regulations will commence on 1 October 2021.

### **Compliance**

- 37 The proposed regulations comply with:
- 37.1. the principles of the Treaty of Waitangi;
  - 37.2. the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;
  - 37.3. the principles and guidelines set out in the Privacy Act 1993;
  - 37.4. relevant international standards and obligations; and
  - 37.5. the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

### *Statutory prerequisites for regulations*

- 38 Section 138(1BA) provides that the Minister may only recommend that regulations prescribing inquiries under section 9C be made after consulting the persons (or the representatives of the persons) who the Minister considers will be substantially affected by the regulations. These requirements have been met.

### **Regulations Review Committee**

- 39 There are no grounds for the Regulations Review Committee to draw the Regulations to the attention of the House of Representatives under Standing Order 319.

### **Certification by Parliamentary Counsel**

- 40 The Regulations have been certified by Parliamentary Counsel Office as being in order for submission to Cabinet.

### **Impact Analysis**

- 41 A Regulatory Impact Assessment was prepared in accordance with the necessary requirements and was submitted at the time that Cabinet approval was sought for the policy relating to the relevant Regulations [DEV-18-MIN-0204].

### **Publicity**

- 42 I intend to publish a press release regarding the making of these Regulations and the consultation on the draft Code. The Ministry of Business, Innovation and Employment (MBIE) will notify interested stakeholders about the consultation on the draft Code.

## Proactive Release

- 43 I intend to release the paper proactively in whole within 30 working days. MBIE will publish a copy on its website.

## Recommendations

I recommend that the Cabinet Business Committee:

### *Implementation of decisions arising from the review of the CCCFA*

- 1 **note** that on 18 September 2018 the previous Government agreed to the development of prescriptive, binding requirements including around affordability, suitability and credit advertising standards and debt collection disclosure [DEV-18-MIN-0204];
- 2 **note** that the Minister of Commerce and Consumer Affairs released an exposure draft of the regulations for consultation in November 2019 and was authorised to make decisions on minor issues in response to feedback on the exposure draft [DEV-18-MIN-0204];
- 3 **note** that the attached Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 will give effect to the decision referred to in paragraphs 1 and 2 above as it relates to affordability and suitability requirements;
- 4 **note** that the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 come into force on 1 October 2021 to align with the commencement of the remaining provisions of the Amendment Act;

### *Authorisation for submission to Executive Council*

- 5 **note** that section 138(1BA) provides that the Minister may only recommend that regulations prescribing inquiries under section 9C be made after consulting the persons (or the representatives of the persons) who the Minister considers will be substantially affected by the regulations;
- 6 **note** the advice of the Minister of Commerce and Consumer Affairs that this requirement has been met;
- 7 **authorise** the submission to the Executive Council of the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 relating to affordability and suitability requirements;

### *Approval to consult on the Responsible Lending Code*

- 8 **authorise** the Minister of Commerce and Consumer Affairs to consult on the updated draft Responsible Lending Code once it is finalised.



**I N C O N F I D E N C E**

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs

**I N C O N F I D E N C E**