Submission on *Exposure draft of updated Credit Contracts and Consumer Finance Regulations 2004 and Responsible Lending Code*

Your name and organisation

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Responses to questions

1	Do you agree with the way that the draft Regulations are phrased? If not, what changes would you make?
	Regulation 4AE: We support the removal of regular 'savings' and 'investments' as examples of outgoings that lenders need to inquire into. This is the bare minimum change that must be made to help alleviate some of the unintended consequences of the recent amendments to the Regulations, and support Cabinet's decision. However, simply removing those two items from the list of examples that lenders are required to take into account as 'listed outgoings' still leaves lenders in an ambiguous position. To make the position unequivocal, and better reflect Cabinet's decision to exclude savings and investments from the definition, the definition of 'listed outgoings' should be refined to expressly exclude these elements. In addition, the current carve out of paragraph (d) of the definition of 'listed outgoings' that excludes regular or frequently recurring outgoings that the borrower 'is unable or unwilling to cease' should be expanded to include those the borrower is unable or unwilling to materially reduce. It should not be an all or nothing equation, and in our view, clarification would provide greater certainty for lenders in applying the Regulations. Regulation 4AK: We construed MBIE's policy statement as intending to clarify that the requirement to obtain information in 'sufficient detail' only relates to information which is provided by borrowers directly (as opposed to information from bank statements). The additional wording would more logically and simply be inserted in Regulation 4AK2(a)(i) to better reflect the policy intent, with Regulation 4AK2(b) deleted altogether.
2	Do you agree with the way that the guidance relating to expenses is communicated in the Draft Code? If not, how do you suggest it is improved?
	We make the following comments in respect of the Draft Code paragraphs below. Paragraph 5.4: The statement that a lender should not 'close their eyes' to information in bank transaction records is redundant in the existing regulatory framework. Using emotive phrases like this in the Code is unhelpful. The existing Regulations already set out in detail where verification is and is not needed if the lender believes the borrower has underestimated their expenses. The wording in paragraph 5.4 does not serve to clarify that the requirement to obtain information in 'sufficient detail' only relates to information provided by borrowers directly, rather than relating to information from bank transaction records. In fact, the proposed wording suggests the opposite could be the case. The Code should state clearly that lenders need not be forensic in their checks against statements, and that cross checks should only be performed to identify inconsistencies that are clear and obvious. The 'close their eyes' reference should be removed. In addition, MBIE should also consider giving effect to the policy objective by allowing more flexibility for discretion by lenders to enable them to rely on the information provided to them by borrowers, as we understand many lenders will also apply a benchmark to sanity check the expenses.

Paragraph 5.6:

The guidance here should recognise that borrowers often will reduce their discretionary expenses once a loan has been entered into, and that lenders and borrowers can and should engage in discussions around this, as part of the affordability assessment. It would be helpful for the Code to confirm what would be considered 'discretionary components'. For example, this could be entertainment expenses, but as with the existing 5.6 example, it could also be takeaways. In the latter example, the Code should make it clear it is reasonable for a lender to discount or disregard such expenses, provided it has engaged with the borrower to agree what discretionary expenditure will change after the loan is entered into.

Paragraph 5.8:

The wording here should be simplified and made more consistent with the statement in the commentary section immediately prior to paragraph 5.8, to state that a lender can use its own discretion when applying the options under Regulation 4AM. The example in paragraph 5.8(c) is not appropriate - see our comments regarding paragraph 5.6 above (where the lender should be able to make adjustments for discretionary expenses provided they are agreed by the borrower).

3	Are there other practices for estimating expenses that the Code should endorse?

We believe there is confusion both at a customer and lender level as to what is clearly considered to be discretionary spending. Neither the Regulations nor the Code adequately recognise that it is common for borrowers' discretionary spending behaviour to change after entering into a new loan to ensure they will be able to repay their loan (see also our comments above regarding paragraph 5.6). The existing list of expenses in the Regulations has been cast too wide, and distinction needs to be made between discretionary spending and spending on basic life necessities. There should be guidance in the Code for lenders to be able to make relevant adjustments for the former when making their inquiries in consultation with, and agreement by, the borrower.

4	Is the new wording in the Draft Code on how lenders may apply a reasonable surplus to comply with regulation 4AF(2)(b)(i) relating to changes to expenses clear? If not, how do you suggest it is improved?

The new wording in the Draft Code could be clearer and less prescriptive. Paragraph 5.19 provides that a reasonable surplus is not required if the lender applies all of the prescribed 'adjustments', being:

- in instances where the borrower has a home loan, or is applying for one, apply an appropriate sensitised interest rate;
- appropriate discounts to volatile, irregular or variable income (if any); and
- compare most living expenses against statistical benchmarks.

As the range of lenders in the market, and the customer types, each greatly differ, it will not always be reasonable or necessary for all lenders in respect of every customer to apply all of the 'adjustments'.

In a home loan context, it may be appropriate for a lender, in the circumstances and dependent on the customer, to only carry out two of three adjustments. For example, the sensitised interest rate one lender may use may be very different to the rate used by another lender, resulting in different sized buffers.

A better approach is to allow more flexibility for lenders to make their own decision regarding adjustments depending on the circumstances, recognising that the type of customers, product types, and lenders under the CCCFA umbrella can vary greatly. Generally, guidance which allows more room for lender discretion rather than prescription is desirable to prevent poor customer outcomes as experienced after the implementation of the December 2021 amendments.

5	Do you have any other proposals for additional guidance on surpluses?

The Code's guidance on surpluses should be reviewed and revised in general to provide greater flexibility.

The requirement for a 'reasonable surplus' still does not adequately address the fact that most prudent lenders' estimates of likely income and likely relevant expenses include reasonable buffers or adjustments to adequately address the risk of overstated income or underestimated expenses. The inclusion of a 'reasonable surplus' in the Regulations, even where it is one or two options which can be applied, risks signalling to lenders that greater surplus levels are required.

Further changes should be made to the Regulations and/or the Draft Code to provide greater flexibility for responsible lenders to apply their own considered judgment in lending decisions given the variety of customer types and credit products.

6	Is the updated guidance and examples on 'obvious' affordability helpful? If not, how could they be improved?

We do not regard the proposed examples of 'obvious' affordability as helpful. The fact scenarios read in a laboured way and are not easily understood. There are also key bits of information missing, for example, in some of the scenarios the expenses are not even mentioned.

The examples are highly specific and raise more questions than answers to assist a lender in determining what may be 'obvious' affordability. We think a guiding set of principles, perhaps with succinct and clear examples (making it clear that it is not an exhaustive list), are a better way of communicating the circumstances where this exception may be relied upon.

7	Do you have any other proposals for additional guidance and examples for 'obvious' affordability?
	A threshold should be introduced for any proposed increase in lending (as a percentage of the existing lending) as an initial starting point for causing the exception to come into effect, subject to a lender still having to make reasonable affordability inquiries. We would also welcome an acknowledgment that it is not unusual for customers and banks to have relatively long relationships over a number of years, and that information the bank already holds when making an 'obvious' determination can be used for this purpose.
8	Would any of these initial changes require changes to lender systems before they could come into force? If so, what are the likely timeframes for making these changes?
	We are not in a position to comment directly on this question. However, our view is a change in lender systems, particularly for large lenders such as banks, is generally not something that can be operationalised quickly. The due diligence duty that applies to directors and senior managers requires that the culture of compliance is driven from the top down, so a reasonable amount of extra time (more likely several months, rather than several weeks) needs to be built in to write, develop and roll out sufficient training for staff as a result of any initial changes.

Other comments

We acknowledge the Minister and Cabinet have expressed an urgent need to provide relief and alleviate some of the unintended consequences caused by the introduction of the new Regulations in December.

However, given the Investigation is still ongoing, and it is likely further changes to the Regulations and Code will again be needed once any recommendations from the Investigation are made, MBIE should continue to actively engage in a dialogue with the major stakeholders in the industry to ensure any changes at this stage are sufficiently clear and robust. This would ensure any changes are not contradicted nor further amended in a second round of amendments after the Investigation is completed later in the year.

Implementing any change in this space is extremely costly for lenders, presumably with some of such costs being passed onto borrowers. It would be unfortunate if multiple rounds of changes are needed to address the unintended consequences created by the new Regulations, which themselves imposed significant cost on the lending sector when first introduced.