

19 April 2022

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Submissions on the updated Credit Contracts and Consumer Finance Regulations 2004 and Responsible Lending Code

1. Introduction

- 1.1. Our submissions are informed by our role as an independent financial dispute resolution scheme which investigates and helps resolve complaints between consumers and financial service providers. We have approximately 360 non-bank lenders as FSCL members, most of which provide consumer credit lending. The type of lending ranges from high-cost credit to lending by finance companies and credit unions.
- 1.2. In the 2020/21 year FSCL investigated 286 disputes, of which 67 were consumer lending complaints (covering consumer credit, mortgage loans, and credit card complaints). We also received more than 500 complaints about lenders through our early assistance service. These complaints were then resolved directly between the lender and the borrower.
- 1.3. In a high number of the irresponsible lending complaints, we see consumers who are often on low, fixed, and sometimes unreliable income. Many live hand to mouth, where the margin between affordability and unaffordability is extremely tight. They often do not have savings, leaving them, generally speaking, more susceptible to financial stress when faced with unexpected or unanticipated costs.

2. Proposed amendments to the regulations

Amendment to 4AK(2)(b)

- 2.1. At a high level, we agree that the requirement to 'ensure that the information used to make the initial estimate is obtained in sufficient detail to minimise the

risk of relevant expenses being missed or underestimated', should only apply where the initial estimate is simply based on an amount declared by a borrower for a particular expense. If some other documentary evidence has been used to estimate the expense, like the bank transaction records (4AK(2)(a)(ii)), or other information (4AK(2)(a)(iii)), then it seems an unnecessary step at the estimation stage to require the 'sufficient detail' check in 4AK(2)(b).

Guidance on 'sufficient detail'

- 2.2. However, we think it would be helpful if there was some guidance in the Code to set out what 'sufficient detail' in 4AK(2)(b) means. To unpack this a little further, the step in 4AK(2)(b) is to ensure that expenses haven't been missed or underestimated. It seems unnecessary to check at this stage whether a declared figure by the borrower is underestimated. This is because, where an expense is declared under 4AK(2)(a)(i), that expense **must** then be verified under regulation 4AM. We therefore submit that the word 'underestimated' in 4AK(2)(b) be deleted.
- 2.3. However, in terms of checking that an expense has not been 'missed', it could be helpful to say in the Code that 'sufficient detail' means that lenders must ensure they ask, in every application, about the typical expenses that all people have. That is, all the examples under 'listed outgoings' under regulation 4AE. This should then mean that there's a low risk of any other expenses, outside the examples of 'listed outgoings', not being identified in the initial estimate.

90 days of bank statements

- 2.4. A primary concern for FSCL is a situation where a lender would not be required to obtain 90 days of bank statements at either the initial estimate or verification stage. Our reading of the regulations is that this could be possible, if an estimate is obtained via 4AK(2)(a)(i) and then verification is carried out via a benchmark in 4AM(2)(b).
- 2.5. In our experience, from the non-bank lending complaints we have investigated, bank statements are the best source of information about a person's living expenses. We consider it is best practice to obtain 90 days of bank statements and lenders should be encouraged to do this. We note that one of our lender members has advised that they will look at a benchmark, the expense amount declared by the borrower, and the amount spent on the expense in the borrower's bank statements, and take the highest figure. This is best practice.

- 2.6. Bank statements also show up other financial commitments that may not have been anticipated by the examples in 'listed outgoings'. Obtaining 90 days of bank statements is also in lenders' best interests. Lenders want to ensure their loans are repaid. Having a full and clear picture of a borrower's financial position before lending would help to mitigate the risk of non-payment.
- 2.7. However, in reality, we think that bank statements will have to be obtained during the verification stage at 4AM in any event, because verification via a benchmark will not be acceptable for most expenses. This is because it appears that what can be a benchmarkable expense is limited, under regulation 4AN, to utilities, food and groceries, and transport expenses. A declared rent amount, for example, would therefore **have** to be verified against the bank statement.
- 2.8. Also, new Code paragraph 5.4 would mean that if the bank statement was obtained to verify the borrower's rent, then the lender could not then 'close their mind' to some other expense on the bank statement they had effectively been 'put on notice of', which may be a red flag that expenses have been missed.

Cash withdrawals

- 2.9. A particular concern we have is in relation to borrowers who make large cash withdrawals and pay for all or most of their living expenses in cash. We see this regularly in complaints we investigate. It means there's no documentary evidence to verify any living costs, and it's in this situation where we think a lender could rely on a benchmark under 4AM(2)(b) (if it is a benchmarkable expense), or an **estimate** under 4AM(2)(c).
- 2.10. The ability to estimate under 4AM(2)(c) would be triggered because verification from the bank statements couldn't occur (because there's only cash withdrawals), and for some non-benchmarkable expenses you couldn't use a benchmark. However, we think 4AM(2)(c) would only be triggered if there had been first a check of the bank statements, which would show the cash withdrawals. And again, under new Code paragraph 5.4, a lender could not then close their mind to a red flag in that bank statement (for example a regular expense not anticipated in the initial estimate).

Regulation 4AN – definition of benchmarkable expenses

- 2.11. We think it would be sensible to amend regulation 4AN to remove 'utilities' as a benchmarkable expense, but add in 'clothing and footwear' and 'health/medical expenses'. This is because utilities are mostly recorded on bank

statements, and do not need to be benchmarked. Spending on utilities is not discretionary in the way discretionary spending on food and clothing can be. Further, people don't generally pay for utilities in an ad hoc way as they do for food and clothing (making those expenses harder to verify from bank statements). The information on the bank statements for utilities is very accurate. Similarly, health and medical expenses are hard to verify from 90 days of bank statements, and are more easily quantified by a benchmark.

- 2.12. We also generally note that data-gathering is only conducted every three years for some benchmark sources (for example the Statistics New Zealand Home Economic Survey). This can lead to the benchmarks quickly becoming outdated, especially in times of high inflation.

3. Proposed amendments to the Code

Regulation 4AM(3)

- 3.1. We consider there could be an error in the diagram on page two of the draft Code, in relation to regulation 4AM(3). The way the diagram reads is that the overall 'common sense' lens anticipated by 4AM(3) is only required if the initial estimate was via a declaration under 4AK(2)(a)(i).
- 3.2. Our reading of 4AM(3) is that the 'common sense' lens applies however the initial estimate was carried out. For example, we would expect a lender to make an adjustment under 4AM(3) even if a bank statement showed a weekly rental amount of \$300 for a family of five people, and that rental amount was verified by a rental agreement. That amount is very low, and the nature of rental accommodation is that it can end within the 'relevant period' (12 months after the loan is granted). In that case there's a high risk that the borrower would soon have to pay a higher rental amount, and therefore the lender should factor in an amount for rent which is closer to usual market rents.

Requirement to confirm an expense declared is likely to reflect the expense over the 'relevant period'

- 3.3. In relation to new Code paragraph 5.5, we think the word 'may' should be changed to 'should'. This is because under 4AK(a)(2)(ii) and (iii), there is a requirement on the lender to **confirm** that the expense as evidenced in the bank statements or other 'recent and reliable information' likely reflects how much the borrower will pay for that expense in the 'relevant period' (12 months after the loan is granted). We also submit that the 'requirement to

confirm an expense declared is likely to reflect the cost of that expense going forward', should be included in regulation 4AK(2)(a)(i) to reflect the wording in 4AK(2)(a)(ii) and (iii).

Benchmarks

- 3.4. New Code guidance at paragraph 5.8 appears to be saying that any expense could be benchmarked. However, our interpretation of regulation 4AN is that only utilities, food and groceries, and transport expenses can be benchmarked.
- 3.5. Also new Code guidance 5.8(a) appears to defeat the purpose of lenders having a choice of whether to verify against the bank statements, or a benchmark. The lender would have to do both to realise that the verified expense is less than the benchmark. Further, if an expense verified against the bank statement was materially less than the benchmark this would raise a red flag about why the verified expense was less. We would then expect the lender to use the 'common sense' adjustment lens anticipated by 4AM(3).
- 3.6. Further, in new Code guidance at paragraph 5.19, we think that 5.19(c) does not make sense, because not all expenses are benchmarkable under regulation 4AN.

Relying on information provided by the borrower

- 3.7. In relation to paragraph 5.9 of the Code guidance, we submit that the wording does not sit well with the repeal of section 9C7 of the Act.

'Obvious there will be no hardship'

- 3.8. Our reading of the examples directly following new Code paragraph 5.27 is that they flow on from one another. In the first paragraph we've assumed the lender has checked the borrower does not have any overdue debt by way of a credit check.
- 3.9. However, in the next paragraph, about the inheritance, we think it would be helpful to say here that the lender has carried out a credit check. We think a credit check would still be necessary (even if a full affordability assessment wasn't), because quite some time could have passed and there's never been any check that the partner (C) does not have overdue debt.
- 3.10. Further, in the next paragraph, there's likely enough income to cover expenses (even if the couple now have children). However, because 10 years have passed

it would again be prudent to check there's no overdue debt that would exhaust the high income.

- 3.11. Lastly, we think the final paragraph in the example about K and C makes little sense. It does not seem plausible that this couple would need to borrow \$5,000 for urgent car repairs, they would just pay in cash or use a credit card. If they were seeking a loan for \$5,000, this would actually be a red flag that they now had high indebtedness.

Please contact us if you wish to discuss this submission further.

Yours sincerely



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