Early implementation and impacts of 1 December 2021 credit law changes

Investigation report

June 2022

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Executive summary

1. On 14 January 2022 the Minister of Commerce and Consumer Affairs asked the Ministry of Business, Innovation and Employment (**MBIE**), in collaboration with Council of Financial Regulators (CoFR), to conduct an investigation into the impacts of the parts of the Credit Contracts Legislation Amendment Act 2019 and Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 that came into force on 1 December 2021 (**CCCFA changes**). This report provides the final findings of the investigation.

2. The CCCFA changes were part of a wider reform to the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**), and included amendments to requirements for affordability and suitability assessments and the associated liability regime. The CCCFA changes were intended to address concerns about continued irresponsible lending that was harming some borrowers. Specifically, the CCCFA changes were intended to result in all consumer lenders implementing credit assessment processes that conformed to the lender responsibility principles around affordability and suitability, including performing 'minimum steps' prescribed in regulations.

3. Since 1 December 2021 there have been reported drops in lending activity across a range of consumer credit products, including home loans, personal loans, credit cards and vehicle lending. The CCCFA changes are one of several factors that have had an impact on home lending, alongside LVR changes, increased interest rates, inflation and a general property market slowdown. For other consumer lending, which tends to be higher risk, there may be some impact from other factors (such as cost of living increases) but the relative impact of CCCFA changes on lending activity is higher.

4. We accept the views of financial mentors and other consumer advocates that most of the benefits sought by the CCCFA changes will take 6–12 months to be visible. This is on the basis that most debts encountered by financial mentors have been incurred some time prior, and in some cases clients have been struggling with accumulated debts for a considerable period before they see a financial mentor.

5. While it is too early to say whether or not the CCCFA changes are likely to be successful in achieving their intent, financial mentors have already reported that the CCCFA changes, particularly new record keeping requirements, have increased their ability to identify irresponsible lending and to make complaints to dispute resolution schemes. This is consistent with the outcomes being sought.

6. However, the CCCFA changes are having some unintended impacts:

a. More borrowers across all lending types who should pass the affordability test are subject to declines or reductions in credit amount.

b. Borrowers are subject to unnecessary or disproportionate inquiries that are perceived by them as intrusive.

7. These unintended impacts are the result of the following:

a. Lending processes have become more restrictive and onerous than was expected when the CCCFA changes were made. This is a consequence of the way a number of specific provisions in the regulations are designed and drafted, combined with interpretational difficulties and many lenders taking a naturally conservative approach to compliance given the CCCFA's strong liability regime.

b. The prescriptive nature of the CCCFA changes and their application to almost all consumer lending also mean that lending has been impacted outside of high-risk consumer lending.

8. The Government has previous announced changes and clarifications to various aspects of the Regulations through both amendments to the Regulations and additional guidance in the Responsible Lending Code. These are expected to come into force in June 2022.

9. We have identified a range of further changes that could be considered to address the unintended impacts of the CCCFA changes. Some of these further changes would be broadly consistent with the intent of the CCCFA changes (such as amending the regulations to target certain types of contracts, borrowers or lenders) while others would represent a policy change away from the CCCFA changes (such as repealing the regulations).

10. While this report provides some analysis of the possible impact of further changes, it does not make policy recommendations. Further design and analysis of these options, and consultation, would be required to pursue them.

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List of Acronyms and Abbreviations

CCCFA	Credit Contracts and Consumer Finance Act 2003
CCCFA changes	Changes to the Credit Contracts and Consumer Finance Act 2003 and Credit Contracts and Consumer Finance Regulations 2004 that came into force on 1 December 2021
CoFR	Council of Financial Regulators
MBIE	Ministry of Business, Innovation and Employment

Introduction

1. On 14 January 2022 the Minister of Commerce and Consumer Affairs asked the Ministry of Business, Innovation and Employment (MBIE), in collaboration with other members of the Council of Financial Regulators (CoFR), to investigate the impacts of amendments to the Credit Contracts and Consumer Finance Act 2003 and Credit Contracts and Consumer Finance Regulations 2004 that came into force on 1 December 2021 (CCCFA changes).

2. The investigation was requested in response to concerns raised by lenders and consumers.

3. The scope of the investigation was the intended or unintended impacts of the CCCFA changes, primarily in relation to mortgage, but also other lending, by banks and nonbank lenders in the current consumer credit market. This includes attempting to separate out the impacts of other factors like global economic conditions, loan-to-value ratio restrictions, and the official cash rate. The terms of reference were published on 31 January and are attached at Annex 1. This report provides the final findings of the investigation.

4. This report is structured in the following chapters:

    a. Chapter One: describes the methodology for the investigation, setting out the lines of inquiry and information basis and associated limitations.

    b. Chapter Two: provides an overview of the CCCFA changes, their policy intent and anticipated impacts.

    c. Chapter Three: describes the implementation of the CCCFA changes, including changes to creditor lending processes and concerns raised.

    d. Chapter Four: provides and overview of the changes to the credit markets and operating environment since 1 December 2021

    e. Chapter Five: provides our assessment of the intended and unintended impacts of the CCCFA changes

    f. Chapter Six: sets out the initial changes agreed to by Government and identifies potential further changes that could be further examined to address unintended impacts of the CCCFA changes.

5. The investigation has been conducted by an MBIE project team in collaboration with a CoFR working group.

Chapter One: Investigation methodology

6. The remainder of this chapter provides an overview of the information sources used for the investigation and associated limitations.

1.1 Information sources

7. MBIE collected both quantitative and qualitative data from a range of primary sources. Further detail is provided in the sections below.

1.1.1 Reserve Bank data

8. The Reserve Bank provided quantitative data and analysis on:

   a. mortgage lending (monthly new mortgage lending, monthly number of mortgage borrowers)

   b. credit card limits and utilisation

   c. seasonal trends in mortgage lending

   d. the impact of loan-to-value ratio restrictions

   e. interest rates

   f. house prices

   g. inflation.

9. This data and the associated analysis were collected to understand trends in the credit market and the relative impact of the CCCFA changes.

1.1.2 Credit reporting agencies data

10. Credit reporting agencies Equifax and Centrix provided data on credit enquiries and new credit accounts. We have also relied on publicly released reports from Centrix (on conversion rates by credit score). This data provided a detailed picture of credit applications and approvals across numerous credit products (home loans, personal loans, credit cards, etc), supplementing official data.

11. Data on new credit accounts and conversion rates was limited to lenders participating in comprehensive credit reporting with the credit reporting agencies providing information. This data was also largely confined to the past two to three years, meaning that relatively little information was available on trends prior to the COVID-19 pandemic.

1.1.3 Interviews with key stakeholders

12. As part of the investigation MBIE conducted a series of semi-structured interviews with 32 stakeholder organisations. These included lenders (bank and non-bank lenders),mortgage brokers, associated industry organisations, and consumer advocates such as financial mentors. We also spoke to credit reporting agencies and financial dispute resolution schemes. We undertook to treat the information received as confidential, and agreed that for the purposes of the report we would aggregate information so that individual stakeholders could not be identified.

13. MBIE's hypothesis was that the CCCFA changes would impact stakeholders in the credit industry differently, and to varying extents. For example, a lender who primarily offers home loans may be impacted differently than a lender who primarily offers personal finance. Thus, MBIE chose to interview a variety of stakeholders within the credit industry to capture the full extent of the CCCFA changes' impacts. The primary purpose of these interviews was to collect qualitative data on the initial implementation of the regime and its impacts, both intended and unintended. The qualitative data collected during these interviews was organised into key themes. Prior to the interviews stakeholders were sent a set of questions to allow them to consider and prepare their responses.

14. Given there are differences in how the CCCFA changes apply, or are utilised, by different kinds of stakeholders, MBIE used separate sets of questions. These questions were separated for two broad categories of stakeholders, as follows:

    a. banks, non-bank lenders and lending intermediaries;

    b. financial dispute resolution schemes, financial mentors, and consumer focused organisations.

15. Please see Annex 2 for the full list of questions sent to banks, lenders and intermediaries, financial dispute resolution schemes, financial mentors and consumer-focused organisations.

1.1.4 Additional data and information from lenders

16. Following the interviews, MBIE also collected specific information and data from lenders via email. Whilst the time periods for the data requests changed depending on when the initial interviews took place, in general the data MBIE collected included:

    a. monthly lending data (across home loans, credit cards, motor vehicle loans, and other consumer credit contracts) up to February 2022 from as far back as reasonably practicable (preferably a five-year time series) for:

        i. loan application volumes (numbers of applications for different categories of loans, see below)

        ii. loan application approval times (from the making of an application to the approval of the application)

        iii. loan 'drop' rates (applications withdrawn before completing the process)

iv. loan application declines

v. total new loan commitments ($).

17. The data provided to MBIE varied between each lender and credit reporting agency.

18. MBIE also specifically requested detailed qualitative information from lenders, including:

a. process maps of lenders post-1 December loan approval processes – in particular, setting out the information flow between the customer and lender, and the assessments performed at each stage, where these vary by product, and a description of the lenders process prior to 1 December and any key differences

b. specific guidance or training materials provided to front-line staff

c. the specific figures lenders have applied as a "reasonable surplus" under regulation 4AF(2)(b)(i), how this was arrived at, how this is applied, and what surplus if any did the lender require before implementation of the 1 December changes

d. the provision of two specific kinds of case studies including:

i. situations in which a specific exemption from a full income and expense assessment (along the lines of regulations 4AG or 4AH) arguably should have been provided for in the regulations and applied, but was not

ii. situations in which inquiries and assessment of expenses under regulation 4AE(d) definition of 'listed outgoings', or expenses that were discretionary in nature, resulted in a poor outcome.

19. Lenders were asked to provide further information on these case studies, such as how the various steps of the credit assessment process were applied, the information flows between the customer/broker and the lender, the assessment performed by the credit provider and its outcome.

20. This data and the case studies were used to inform MBIE as to how lenders had implemented the CCCFA changes, and how different aspects of the CCCFA changes were impacting on outcomes. This was important for identifying causal connections between aggregate lending data and the CCCFA changes, illustrating the varied processes and experiences of lenders, and supporting the case for further changes to legislation and guidance.

1.2 Limitations

21. The assessment of the CCCFA impact on credit markets, and particularly its likely ongoing impacts, has limitations due to the short time period since implementation of the CCCFA changes. Our analysis was primarily based on data provided by RBNZ, credit rating agencies and lenders up to January/February 2022. Lenders have not had a long period since 1 December to adjust and improve their new processes.

22. There are differences in data collection methods and measures between lenders and credit reporting agencies, and much of the data used was incomplete or not in form where it could

be readily aggregated with data from other sources. This was mitigated by clarifying with lenders and credit reporting agencies how they define and collect certain data. The qualitative data gathered may be subject to self-reporting bias; where possible, this was mitigated by following up with requests for quantitative data to support claims made.

23. Due to time constraints, MBIE was unable to meet with many lenders in the industry. This limitation was mitigated by ensuring we met with industry representatives who spoke on behalf of particular kinds of lenders. The investigation largely interviewed lenders who were known, prior to 1 December, to have relatively robust affordability processes – these lenders were best placed to report on unintended impacts. Therefore, we did not collect direct evidence of lenders with generally weaker processes strengthening them.

24. MBIE has also been unable to draw conclusions on some of the potential unintended impacts revealed in the course of the investigation (for instance, impacts on particular groups of consumers and small businesses) due to information and time constraints.

Chapter Two: December 2021 credit law changes

25. This chapter provides an overview of the key CCCFA changes and their policy intent.

2.1 Overview of key changes

26. The CCCFA changes that came into effect on 1 December 2021 were made by the Credit Contracts Legislation Amendment Act 2019, the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 and the Credit Contracts and Consumer Finance Amendment Regulations 2020. The Responsible Lending Code (the Code) was amended at the same time to provide non-binding guidance on the CCCFA changes.

27. A number of changes made by the Credit Contracts Legislation Amendment Act 2019 came into effect from 20 December 2019 through to 1 October 2021. These included a new civil penalty and statutory damages regime for breaches of lender responsibilities, and interest and fee caps on high-cost consumer credit contracts.

28. However, the most significant changes came into effect on 1 December 2021. These are summarised in the table below.

TABLE 1: 1 DECEMBER 2021 CHANGES TO CREDIT LAWS

CHANGE	DESCRIPTION OF LAW BEFORE 1 DECEMBER 2021	DESCRIPTION OF LAW AFTER 1 DECEMBER 2021
Prescriptive affordability and suitability assessments, and responsible advertising requirements	Lender responsibilities were principle-based, supported by non-binding guidance in the Responsible Lending Code.	Regulations set new minimum requirements for: • affordability and suitability assessments (new regulations 4AA-4AO) • responsible advertising (new regulations 4AAAP–4AAB).
Affordability and suitability inquiries for further lending	No express obligation to carry out affordability or suitability assessments for loan top-ups and credit limit increases (unless a new contract was entered into), but the Code recommended taking some steps to ensure that additional lending was affordable.	Affordability and suitability assessments required for top-ups and credit limit increases (amended section 9C(3)(a) and new section 9C(8)).
Record keeping of affordability and suitability assessments	No record-keeping requirements.	New requirements to keep records of: • affordability and suitability assessments (new section 9CA) • how credit fees are calculated (new section 41A).

Advertising in specific languages	Lender responsibility to assist borrowers to make an informed decision.	New requirement for lenders who advertise credit in a language to provide information to borrowers in that same language as well as, where applicable, take reasonable steps to provide guarantors information in that same language (new section 9C(3)(b)(iv) and 9C(4)(b)(iii)).
Disclosure about dispute resolution services and financial mentoring services	Information about dispute resolution services disclosed before credit contracts entered into. No information required to be provided about financial mentoring services.	Lenders must provide information to borrowers about the lender's dispute resolution scheme when a borrower seeks hardship relief or makes a complaint. Lenders must provide information to borrowers about financial mentoring services (e.g. MoneyTalks) when a borrower defaults, seeks hardship assistance, or if the lender declines an application for a high-cost consumer credit contract. (New section 26B and new regulation 5A)
Debt collection disclosure	No disclosure requirements for debt collection, except for advising the borrower if rights to the debt are transferred to another creditor (section 26A).	Before a debt collector undertakes debt collection, they must disclose specified information about the debt (new section 132A and new regulation 23).
Directors and senior managers duties	No duties on directors and senior managers, except for potential liability for offences and compensation orders where individuals have intentionally contributed to a breach of the CCCFA.	Directors and senior managers of lenders must exercise due diligence to ensure that the lender complies with its duties and obligations under this Act. This includes taking reasonable steps to ensure that the creditor has the appropriate procedures for complying with the CCCFA, identifying deficiencies in CCCFA compliance and remedying any deficiencies discovered (new section 59B).
Requirement to provide an annual return	No requirement to provide an annual return to the Commerce Commission (the Commission).	Every lender under a consumer credit contract must provide an annual return to the Commission, which may include providing statistical information in relation to the lender's business across a 12 month period (new section 116AAA).

29. Further detailed descriptions of the key changes that have been the focus of the investigation based on interviews with stakeholders are provided below.

2.1.1 Prescriptive affordability and suitability assessment requirements

30. Since June 2015, lenders have been 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[1], so as to be satisfied that it is likely that:

    a. the credit or finance provided under the agreement will meet the borrower's requirements and objectives ('suitability')

    b. the borrower will make the payments under the agreement without suffering substantial hardship ('affordability').

[1] A consumer credit contract is as a credit contract in which (a) the debtor is a natural person; (b) the credit is to be used wholly or predominantly for personal, domestic, or household purposes; (c) interest or credit fees are charged, or a security interest is taken; and (d) the creditor provides credit as part of a business or introduced by a paid adviser.

31. These were principle-based requirements, supported by non-binding guidance in the Code. The Code guidance sets out various inquiries that lenders *should* make or *may* make, in order to comply with the above lender responsibilities.

32. The Credit Contracts Legislation Amendment Act 2019 added section 9C(5A) of the Act, which provides that the obligation to make 'reasonable inquiries' into affordability and suitability includes a requirement to comply with regulations made under section 138(1)(abd). Section 138(1)(abd) is a regulation-making power that allows regulations to set out specific inquiries that must be made, the processes that lenders must follow, and how lenders must take into account information received in satisfying themselves as to affordability and suitability. Following the Credit Contracts Legislation Amendment Act 2019, new regulations were made in November 2020. The Regulations include specific inquiries that lenders must undertake, and the circumstances in which a lender may be satisfied as to affordability and suitability, which are summarised below.

33. 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. The Code suggests this includes where conflicting information is received in response to prescribed inquiries.

2.1.1.1 Suitability regulations

34. Regulations 4AA and 4AB specify aspects of the borrower's requirements and objectives that lenders must inquire into as part of their responsibility to determine the suitability of consumer credit contracts. These aspects include:

    a. the amount of credit the borrower is seeking

    b. the borrower's purpose for the credit

    c. the term of the credit the borrower wants

    d. if lump sum payments are required, whether the borrower prefers them to regular payments

    e. if the credit contract includes 'add-ons' such as repayment waivers, extended warranties or credit-related insurance, whether the borrower requires these add-ons and accepts the additional costs

    f. if the credit is for refinancing, whether the borrower accepts any additional interest and fees they may incur

    g. if the credit is for a reverse mortgage, considering the borrower's future needs.

35. 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.

2.1.1.2 Affordability regulations

36. Regulations 4AC–4AO provide more detail about how lenders must meet their obligation to assess the affordability of consumer credit contracts.

37. In most cases, the Regulations require lenders to estimate the borrower's likely income and expenses (regulation 4AF(2)(a)). The lender must show that the borrower's income exceeds their expenses (including payments under the new loan) and make an allowance for error (e.g. overestimation of income or underestimation of expenses) (regulation 4AF(2)(b)).

38. An income and expenses assessment is not required if:

    a. initial inquiries show that it is obvious that the borrower will be able to make payments under the agreement (regulation 4AG)

    b. the borrower will not rely on income to make the payments and the lender is satisfied that payments will not cause substantial hardship (e.g. the borrower will pay off the loan using the sale of an asset) (regulation 4AF(1)(b) and regulation 4AI), or

    c. 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) (regulation 4AH).

39. 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.

40. 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) (regulation 4AJ).

41. For expenses, lenders can ask the borrower, use their existing records, or determine the borrower's expenses from bank transaction records (regulation 4AK(2)(a)). 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 (regulation 4AK(2)(c) and (3)). If estimated expenses are based on asking the borrower, or there is otherwise 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 (regulation 4AM).

42. Income is required to exceed expenses (regulation 4AF(2)(b)), and there must be one or both of the following:

    a. a reasonable surplus on top of likely expenses, to allow for potential overestimation of income or underestimation of expenses, and/or

    b. adjustments and buffers to income and expenses, to allow for potential overestimation of income or underestimation of expenses.

2.1.2 Record keeping of affordability and suitability assessments

43. Prior to the CCCFA changes, there were no obligations for lenders to keep records of their affordability and suitability assessments.

44. New section 9CA of the CCCFA requires lenders to keep records about the affordability and suitability inquiries made by the lender and the results of those inquiries. These records must demonstrate how the lender has satisfied itself as to the affordability and suitability of the credit contract.

45. The Code provides further guidance on the records that should be kept. This list of information largely mirrors the inquiries required by the Regulations, and essentially requires lenders to retain copies of information provided to them by the borrower, a breakdown of the lender's initial estimates of likely income and expenses, information about how those have been adjusted through verification or the use of benchmarks, and the specific reasons why the loan was affordable (e.g. likely income exceeded likely expenses with a reasonable surplus).

2.1.3 Directors' and senior managers' liability

46. New section 59B provides that directors and senior managers[2] of lenders must exercise due diligence to ensure that the creditor complies with its duties and obligations under the CCCFA. Directors and senior managers are not automatically liable if the creditor breaches the CCCFA. However, they must take reasonable steps to ensure that the creditor has appropriate procedures for complying with the CCCFA, identifying deficiencies in CCCFA compliance and remedying any deficiencies discovered.

47. Breaches of section 59B can result in civil pecuniary penalties of up to $200,000, and potential personal liability for statutory damages and compensation awards.

2.2 Policy intent of new affordability and suitability assessment requirements and associated liability regime

48. The new affordability and suitability requirements and associated liability regime were intended to address one of four key issues identified by MBIE's 2018 Review of Consumer Credit Law: 'continued irresponsible lending and other non-compliance' (**the 2018 Review**).

49. The 2018 Review reported that 'from our stakeholder interviews and desk-based research, there appear to be unacceptable rates of non-compliance with a range of CCCFA obligations (particularly the responsible lending obligations and public disclosure requirements introduced in 2015) and this is causing considerable harm to vulnerable borrowers'.

50. Based on input from consumer groups, regulators, financial dispute resolution schemes and lenders, the 2018 Review concluded that there were a range of non-compliance issues across affordability and suitability, as well as other lender responsibilities and CCCFA obligations (e.g. the prohibition on unreasonable fees).

51. The 2018 Review stated that there was 'relatively little information about the prevalence of problems across particular types of lenders', although 'consumer stakeholders have identified irresponsible lending across all types of lenders'. Available information suggested that

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[2] 'Senior manager' has the same meaning as in the Financial Markets Conduct Act and is defined as a person who is not a director but occupies a position that allows that person to exercise significant influence over the management or administration of the business (for example, a chief executive or a chief financial officer).

concerns were 'particularly concentrated across finance companies and high-cost lenders'. The most serious cases involved some lenders performing 'only superficial testing of loan affordability and taking income and expense information provided to them by borrowers without proper questioning or verification, even where it was plainly incomplete or incorrect'.

52. Credit card lending by banks was also cited as a source of issues, and the review noted allegations of irresponsible mortgage and consumer lending by banks raised in hearings of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

53. Contributors to non-compliance were identified as including:

    a. a lack of clarity about what was required to comply with the lender responsibilities, which made it more likely that lenders would interpret the responsibilities in ways inconsistent with the intent, and reduce the ability for financial mentors and consumers to complain to the Commerce Commission and financial dispute resolution bodies

    b. inadequate documentation of lender processes and evidence relied on in affordability and suitability assessments, making it more difficult to identify non-compliant processes

    c. a lack of any penalties for breach of lender responsibilities failed to incentivise compliance.

54. The review findings in relation to responsible lending were largely based on case studies and qualitative insights from lenders and consumer advocates, rather than quantitative evidence.

55. The review proposed, and ultimately resulted in the implementation of, the CCCFA changes detailed above.

56. The CCCFA changes were intended to result in all consumer lenders implementing credit assessment processes that conformed to the lender responsibility principles around affordability and suitability. This would include all lenders performing certain 'minimum steps' prescribed in regulations that would help to ensure that information relied upon to estimate the borrower's income and expenses and confirm affordability was robust and justifiable. Where breaches of lender responsibilities occurred, the intention was that these could be readily identified by financial mentors and consumers through lender recordkeeping and appropriate complaints made to the Commerce Commission and financial dispute resolution schemes.

57. The CCCFA changes intended to give some discretion for lenders to adopt different processes, recognising that there was a variety of existing good practice across the sector. For example, lenders were intended to have choices about whether borrower expenses were estimated based on information provided by the borrower, the borrower's bank transaction records or other information already held by the lender. While all expenses would need some degree of checking, this could be either verified against documentary evidence (e.g. bank statements) or, where appropriate, comparison against a statistical benchmark.

Chapter Three: Implementation of the CCCFA changes and stakeholder concerns

58. This chapter sets out:

    a. expected process changes

    b. aggregate information lenders have reported changes made to their processes to implement the CCCFA changes, particularly new prescriptive affordability assessment regulations

    c. concerns raised by lenders and other stakeholders about the impacts of implementation.

59. This chapter relates only to changes to lender processes in response to the new affordability requirements in the Regulations, as this is where most of the changes were made, and concerns raised by lenders and other stakeholders. This chapter does not address other changes, including around suitability, record keeping, fees, disclosure, advertising, or due diligence.

60. Throughout this chapter, any reference to lenders, their response to the changes, or their concerns, refers only to lenders we have spoken to as part of the investigation. Furthermore, we recognise that lenders who participated in the investigation represent a small subset of views which may exist in the industry. For example, when we refer to most lenders, we are specifically referring to most of the lenders that we have engaged with, not necessarily those within the industry as a whole.

3.1 Expected process changes for new affordability and suitability assessment requirements and associated liability regime

61. As part of developing the new affordability requirements in the Regulations, MBIE carried out consultation throughout 2020 in order to ensure the new regulations aligned as closely as possible with existing good lender practice, having regard to guidance in the Responsible Lending Code. This included releasing three rounds of exposure drafts of the regulations to public or targeted consultation and many detailed discussions and workshops with lenders, financial mentors and other stakeholders.

62. By the time the regulations were made in November 2020, MBIE reported to the Minister of Commerce and Consumer Affairs that it expected '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'. It was noted that 'only a minority of consumer lenders currently do all of the prescribed steps all of the time'. MBIE predicted that changes to processes were likely to be in two main areas:

a. A range of banks and finance companies were likely to verify a wider range of expenses.

b. Some finance companies would likely make more use of statistical benchmarks to ensure that the living expenses estimates provided by borrowers are realistic.[3]

63. Where lenders were expected to make more significant adjustments, this reflected an earlier MBIE finding that a subset of lenders (including some large finance companies) placed a high degree of reliance on unverified statements from borrowers about income and expenses. MBIE considered these practices were at risk of breaching existing lender responsibility principles and would need to be changed significantly to ensure compliance with both the existing law and new Regulations.[4]

3.2 Process changes made in response to new prescriptive affordability requirements

64. Prior to the 1 December CCCFA changes, lenders designed their processes for affordability assessments based on the principles-based approach in the Act, backed by practical guidance in the Responsible Lending Code. Lender responsibility principles included the responsibility to exercise the care, diligence and skill of a responsible lender, and make reasonable inquiries to satisfy itself that it is likely that payments will be made without the borrower suffering substantial hardship. While lenders were expected to make inquiries into a borrower's income and expenses to assess affordability, those inquiries were not prescribed.

65. As discussed in Chapter Two, section 9C(5A) of the Act now provides that lenders must comply with the Regulations, which prescribe minimum objective requirements for these inquiries. An affordability assessment flowchart summarising these requirements can be found in the Responsible Lending Code.[5]

66. This section uses information provided by lenders to describe key process changes in relation to:

a. income estimates (regulations 4AF(2)(a)(i) and 4AJ)

b. initial expense estimates (regulations 4AF(2)(a)(ii), 4AE, and 4AK), particularly for:

i. the range of expenses captured

ii. the way information about expenses is collected

iii. the number, scope and detail of information sources used

c. verification and adjustment of initial expense estimates (regulation 4AM)

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[3] Ministry of Business Innovation and Employment, *Draft Cabinet paper and regulations about affordability and suitability inquiries for consumer credit,* Briefing 2021-1148 to the Minister of Commerce and Consumer Affairs, 12 November 2020.
[4] Ministry of Business Innovation and Employment, *Credit Contracts and Consumer Finance Amendment Regulations 2020 – Affordability and suitability,* Briefing 2369 19-20 to the Minister of Commerce and Consumer Affairs, 28 February 2020.
[5] Ministry of Business, Innovation and Employment, *Responsible Lending Code*, page 25.

d. application of buffers, adjustments and reasonable surplus requirements in lending decisions ((4AF(2)(b)).

67. The implementation of the new regulations has differed from what was intended in some respects. As described below, in practice, process changes have varied between lenders reflecting differences in their original processes and a small degree of discretion in applying the regulations.

TABLE 2: SUMMARY OF PROCESS CHANGES MADE FOLLOWING THE CCCFA CHANGES

- Most lenders are capturing a wider range of expenses in response to the definition of 'listed outgoings' in regulation 4AE, particularly paragraph (d) (other regular outgoings).
- Many lenders have changed their approach to collecting information about expenses in response to regulation 4AK(2)(a).
- Most lenders are using information with a higher level of detail to capture and verify expenses in response to regulation 4AK(2)(b).
- Most lenders have tightened their verification processes under regulation 4AM.
- Many lenders are strictly applying reasonable surplus requirements under regulation 4AF(2)(b)(i).
- Many lenders are applying a reasonable surplus in addition to buffers and adjustments, going beyond what is required by regulation 4AF(2)(b).

3.2.1 Process changes made to income estimates

3.2.1.1 The approach prior to the CCCFA changes

68. Under the previous regime, inquiries into income focused on the borrower's current income level, the sources and stability of the borrower's income, including likely changes, and (where relevant) the type of credit agreement and the likely proceeds from intended sale of assets.

69. Prior to the changes, most of the interviewed lenders inquired about salary and wages, rental, share investments and benefit income when conducting an affordability assessment. One non-bank lender stated they excluded temporary benefits, irregular income and one-off income, but otherwise included all regular income. Most bank lenders also stated they discounted variable income at a lower rate prior to the CCCFA changes.

70. Prior to the changes, most lenders used a combination of methods to capture and verify income. Most lenders who shared information had robust processes and would use payments to accounts, documentary evidence like payslips or WINZ documents, borrower disclosures and bank statements to collect and verify income. The exception was one small bank lender, who only verified income using bank statements from the main transactional account.

71. The methods bank lenders used to verify income were largely dependent on product type. Bank lenders had more robust processes for capturing and verifying income for a mortgage then they had for a small credit card limit increase. The former often required strong documentary evidence of income, whilst the latter often only required the customer disclosure and a good borrowing history.

3.2.1.2 New requirements in regulations 4AF(2)(a)(i) and 4AJ

72. Regulation 4AF(2)(a) requires lenders to make reasonable inquiries to estimate a borrower's likely income, following the requirements set out in 4AJ.

73. Regulation 4AJ requires the lender to estimate the borrower's likely income either by:

    a. inquiring with the borrower and verifying income using reliable evidence, or

    b. using recent and reliable information the lender holds about the borrower's income and confirming with the borrower that the amounts reflect the borrower's income.

74. 4AJ(2)(b) also requires lenders to inquire about any likely changes to their income.

3.2.1.3 Implementation of new regulations 4AF(2)(a) and 4AJ

75. Overall, lenders we spoke to have not indicated any significant changes to the income categories assessed, or the information sources used to capture and verify income. Bank lenders also continue to discount variable income, although in some cases bank lenders are assessing more income as being at higher risk of variability than they did before the changes. One non-bank lender ensures the income calculation is sustainable by measuring it for consistency across previous months and smoothing any fluctuations.

76. A notable change is that lenders are now required to inquire into likely changes to income, for example when the borrower is going on parental leave. Because of this, lenders should make further inquiries or require more evidence than previously of a change in income level to assess whether the customer will be able to afford lending for the full period of the loan. Three lenders shared that their process now explicitly reflects this requirement.

77. Another key change is that the same prescriptive income assessment requirements apply to all product types, where lenders had greater discretion previously. This means lenders are now applying the same process for small credit increases as they would for a mortgage. This resulted in greater changes by banks who used a combination of methods to verify income prior to the changes based on the product type and perceived risk.

3.2.2 Process changes in relation to expense estimates

3.2.2.1 Changes to the range of expenses captured in response to regulation 4AE

3.2.2.1.1 The range of expenses captured prior to the changes

78. Prior to the changes, all bank lenders interviewed captured grouped living expenses, debt commitments, fixed financial commitments and some discretionary expenses. The description and composition of these broader expense groups varied across bank lenders, but consistently contained 'core' or 'significant' expenses. Core or significant expenses numbered between 7–10 categories for large bank lenders, but less for small bank and non-bank lenders.

79. Of the non-bank lenders we have obtained information from, one shared the categories of expenses they collected information on included rent payments, transfers to other accounts

and discretionary entertainment expenses. One other non-bank lender shared they captured all regular essential outgoings from the borrower's bank account.

80. One small bank lender, who focuses on home and motor vehicle lending, only collected information about the borrower's rent/mortgage payments, financial commitments, and debt servicing obligations and then used statistically modelled living expenses.

3.2.2.1.2 New categories of expenses provided for under regulation 4AE

81. Regulation 4AE sets out the categories of outgoings which must be captured when estimating expenses:

    a. fixed financial commitments, including accommodation costs, insurance, rates, body corporate fees, school fees and child support

    b. debt repayments, existing or resulting from the agreement being entered into or materially changed

    c. living expenses, including utilities, food and groceries, personal expenses including clothing and personal care, costs associated with dependents, medical expenses and transport expenses

    d. regular and frequently recurring outgoings, for example savings, investments, gym memberships, entertainment costs or tithing, that are material to the estimate of relevant expenses and that the borrower is unable or unwilling to cease after the agreement is entered into or materially changed.

82. The examples given within each of these categories are not exhaustive.

3.2.2.1.3 The range of expenses captured increased in response to regulation 4AE

83. In response to regulation 4AE, there has been an increase in the range of expenses captured by all lenders who shared information. The range of expenses captured has increased particularly in response to paragraph (d) of the definition of 'listed outgoings' (regulation 4AE), as all bank and non-bank lenders include more categories of 'regular or frequently recurring' or other discretionary expenses that borrowers are unwilling to forego at the time of the application. Furthermore, most large and small bank lenders are including expenses that are changing or likely to change over the next 12 months, including discretionary food expenses and seasonal expenses.

84. One large bank lender commented that the types of expenses included within discretionary expenses and assessed as regular or frequently occurring has increased to a "significant number", given a significant portion of borrowers' uncommitted monthly income (UMI) will be used on discretionary expenses.

85. Examples of expenses being captured by most lenders we interviewed that were not typically captured prior to the changes include:

    a. regular savings or investments

    b. optional increased loan repayments

c. Buy-Now Pay-Later (BNPL) commitments

d. takeaways

e. entertainment expenses

f. donations, tithing, community contributions.

86. Most non-bank lenders indicated that their tools and processes have been adjusted to include extra steps to capture non-essential or discretionary expenses which were previously excluded. For example, the non-bank lender who already comprehensively captured regular essential outgoings using an income and expense tool to scrape transaction history now also captures frequently recurring expenses of a non-essential or discretionary nature. Another non-bank lender who previously only captured discretionary entertainment expenses stated they feel they no longer have discretion to determine which discretionary expenses they include in their evaluation, as they consider that all discretionary expenses must be included under the new definition in 4AE.

87. Importantly, some large bank lenders expressly indicated a smaller range of expenses were captured for consumer finance than for home loans prior to the changes. Following the changes, the range of expenses captured is the same for all product types. Thus, large bank lenders have seen more process change when conducting affordability assessments for some product types than others.

3.2.2.2 Changes to the approach to collecting expenses in response to regulation 4AK

3.2.2.2.1 Approach to collecting expenses prior to the changes

88. Prior to the changes, lenders used a combination of methods to collect expenses. Typically, more robust and comprehensive sources of information were used to make expense estimates for mortgage lending than other types of consumer finance, due to the increased level of risk of higher value loans for lenders.

89. For living expenses, financial commitments and discretionary expenses, the focus was largely on customer disclosures, with the view that gaps or inaccuracies in expense declarations would be highlighted upon verification against bank statements or benchmarks, or upon lender assessment of reasonableness.

90. Information about debt commitments was more likely to be captured from more detailed sources such as bank statements or credit reports. One lender used negative credit checks but indicated prior to the changes they were moving to use comprehensive credit checks.

91. One small bank and one non-bank lender made their initial expense estimate by scraping bank transactions in the first instance and using customer disclosures to verify the estimate accurately reflected their expenses in the second instance. One non-bank lender highlighted expenses using an external credit reporting tool.

3.2.2.2.2 New requirements in regulation 4AK

92. Regulation 4AK sets out how lenders make an initial estimate of a borrower's likely relevant expenses to satisfy regulation 4AF(2)(a)(ii). Lenders must make an initial estimate based on one or more of the following options:

    a. asking the borrower about their relevant expenses

    b. obtaining 90 days of recent transaction records from bank accounts from which expenses have been paid, or

    c. recent and reliable information the lender holds about the borrower's relevant expenses.

93. For the latter two options, the lender must confirm with the borrower that the amounts reflect likely relevant expenses.

94. Lenders must also ensure the information is obtained in sufficient detail to minimise the risk of material expenses being missed and make reasonable inquiries about whether any financial commitments may have been omitted from the initial estimate.

3.2.2.2.3 The approach to collecting expenses has become more onerous in response to regulation 4AK

95. There has been a varied response to 4AK amongst lenders. However, most lenders are now consistently collecting information from sources with a higher level of detail.

96. We observed (where information was shared by lenders) that when customers are asked to declare expenses, the number of line items they are asked to declare has increased. This is largely in response to the number of discretionary expense types that are being included within the broader expense category – for example, including takeaway expenses within the general living expense category. This is the case for most bank and non-bank lenders who still collect some or all expenses through customer declarations.

97. For the lenders who shared information about their processes prior to the changes, we were able to make a comparison between the number of expense categories used by lenders prior to and following the changes. We observe there has been an increase in the number of categories in all these lenders' internal categorisation of expenses, to varying extents. For example, one large bank lender now captures expenses at a granular level for 35 different categories of expenses, whilst prior to the changes they were caught at the grouped level within 7 different categories.

98. One of the large bank lenders has implemented 4AK to the effect that expense estimates for all expense categories are generated from bank transactions in the first instance. This lender uses income and expense tools to scrape bank statements for all expenses that fit within the new, wider range of expense categories. This lender then typically confirms with the borrower what expenses are regular and recurring and will continue after drawdown.

99. The rest of the large bank lenders we interviewed use some information sources to estimate some types of expenses, and other information sources to estimate other types of expenses.

For example, living expenses may be estimated using borrower declarations made in a granular level of detail, in the first instance. In contrast, discretionary expenses, debt and fixed financial commitments are identified through bank statements or credit reports in the first instance.

100. Most small bank lenders are still using borrower disclosures to collect information. However, most small bank lenders are now also collecting information from 90 days of bank statements to verify under 4AM and ensure all categories of expenses are fully captured from accounts where outgoings are present.

101. Most non-bank lenders indicated that their process for collecting information now reflects the higher level of detail required by the regulations. Specifically, one non-bank lender indicated that customers are now required to provide a higher level of detail in support of declarations, including for credit cards, overdraft and other revolving credit facilities and limits in place. For non-bank lenders, the number of information sources has largely increased in the verification stage of their process, in response to regulation 4AM, rather than in the initial collection of expenses under 4AK.

102. Importantly, all lenders are also applying the same approach to the information sources used and method of collecting expenses across all lending types following the changes, where the large majority would have used a different approach for different lending products prior to the changes.

3.2.2.3 Changes to the expense verification process in response to 4AM

3.2.2.3.1 Approach to verifying expenses prior to the changes

103. Prior to the changes, all large bank lenders used a mix of processes to verify and adjust *significant* expenses. For example:

    a. there was an ability to accept customer disclosures for some expense types (fixed financial commitments, living expenses and discretionary expenses) so long as declarations were reviewed for reasonableness. Where disclosure discrepancies were suspected, lenders would review bank statements or credit checks for undisclosed financial commitments

    b. debt commitments could be verified by internal systems, bank records or credit checks by most large bank lenders

    c. for benchmarkable expenses, lenders used the higher of the customer declared or benchmarked value to verify and adjust living expenses.

104. The two small bank lenders who shared information about their process prior to the changes had a varied approach to verifying expenses:

    a. One small bank lender validated expenses by reviewing transactional and lending statements. Adverse patterns of behaviour would impact the ability to grant credit or warrant further inquiry. This lender also ran regular benchmarking exercises to keep staff informed about the reasonableness of customer declarations.

b. One small bank lender did not verify expense information where there was an excellent credit profile and a belief the borrower had disclosed their true financial position. Where this was not the case, the lender verified transactions from the borrower's main transactional account and in some circumstances asked for extra documentary evidence where there was a weak credit profile or negative surplus.

105. The non-bank lenders who provided information about their processes prior to the changes stated they conducted an automatic analysis of three months' worth of bank statements and compared actual expenses to declared and benchmarked expenses for each category. Additionally, one of these non-bank lenders already benchmarked expenses and comprehensively verified expense line items against evidence provided.

3.2.2.3.2 New requirements in regulation 4AM

106. Under regulation 4AM, where the initial estimate was based on asking the borrower about relevant expenses, or if there is a significant risk the initial estimate materially underestimates relevant expenses, lenders must do one or more of the following:

a. verify the amount of the expenses using 90 days of transaction records from the relevant account, a copy of a contract or invoice or any other reliable evidence

b. for benchmarkable expenses, use the higher of the initial estimate and the benchmark

c. if neither of the previous options are practicable, estimate a reasonable cost for the expense.

107. Under regulation 4AN, an expense is a benchmarkable expense if it is an expense for which the lender may use statistical information about household expenditure.

3.2.2.3.3 Lenders have tightened their expense verification process in response to regulation 4AM

108. Most bank lenders shared they have tightened their processes and verify *all* expenses following the CCCFA changes. Most bank lenders and some non-bank lenders use 90 days of transaction records to verify or (in some cases) adjust declared expenses and make inquiries with the customer to confirm discretionary components the customer is willing or unwilling to forego at the time of entering the contract. Some bank lenders who did not previously verify debt commitments against a wide range of sources also shared information demonstrating they are now doing so, including verifying against internal systems, credit reports and other reliable evidence. Some bank lenders consider that more verification documentation is required for certain categories of expenses such as (but not limited to) private education, tithing and other discretionary and material expenses.

109. Many lenders are benchmarking core living expenses against statistical data and will also use the higher value between the benchmark and the bank statement or customer declaration. For most lenders, where benchmarks cannot be used, these expenses are verified by reviewing statements, invoices or other means.

110. Some bank lenders indicated they will manually review (and a few indicated they would make reasonable inquiries with customers about) which expenses are regular and recurring and material to the estimate. Some small bank lenders shared they will manually review the 90-day

statement period where the verification tool could not accurately be used, usually due to one-off large ticket items or higher seasonal expenditure.

111. Evidence provided by one non-bank lender demonstrates that it is now verifying expenses using a wider range of sources, including bank statements, loan documents and credit reports. This lender said that they review every transaction to ensure the correct expenses have been captured. A lender who already verified against reliable evidence and benchmarked expenses indicated their process has not materially changed and noted benchmarking can help to adjust expenses down.

3.2.3 Process changes to satisfy the requirement in regulation 4AF that borrowers can make repayments with low risk of substantial difficulty

3.2.3.1 Approach to applying surpluses prior to the changes

112. Prior to the changes, most bank and non-bank lenders used an internal reasonable surplus calculation to inform lending decisions. However, because there was no requirement to apply a reasonable surplus, a negative uncommitted monthly income (UMI) or surplus did not automatically preclude approval.

113. Prior to the changes, most bank and non-bank lenders would also discount certain income types to reflect uncertainty or adjust expenses to a statistical benchmark and built buffers into their assessment of fixed and debt commitments such as overdrafts, credit cards and home loans to account for any assumptions. Buffers were also used to account for other factors, such as fluctuating interest rates.

3.2.3.2 New requirements in regulation 4AF

114. The second part of the 4AF inquiry requires lenders to be satisfied borrowers can make repayments without suffering substantial hardship, which requires establishing that likely income exceeds likely relevant expenses. It also requires 1 or both of the following:

   a. the application of a reasonable surplus (a minimum amount of uncommitted income left after the income and expenses assessment)

   b. the application of reasonable buffers and adjustments (adjusting income and expenses to account for variability).

3.2.3.3 The application of reasonable surplus is more restrictive in response to regulation 4AF

115. Following the CCCFA changes, all lenders have a minimum reasonable surplus requirement which borrowers must meet for lending to be approved. While many lenders highlighted surpluses as a concern, only a few shared how their surpluses had increased following the CCCFA changes and most lenders appear to have kept their surpluses the same.

116. However, all lenders who shared information about their reasonable surplus requirements indicated their processes have changed to reduce flexibility, with a reasonable surplus largely being treated as mandatory to approve lending, even where the lender has applied buffers or adjustments to the expense estimate. Only two bank lenders (one small and one large)

indicated their process enabled consideration of mitigating circumstances where reasonable surplus requirements are not met. Case studies also demonstrated that in these circumstances, mitigating factors like a strong asset portfolio or excellent borrowing history were ultimately not enough to outweigh the prescriptive requirements under 4AF.

117. Overall, this demonstrates a more restrictive approach to the application of reasonable surplus requirements following the 1 Dec changes.

3.2.3.4 Buffers are applied alongside surpluses in response to regulation 4AF

118. Following the changes, lenders continue to, to varying extents, apply buffers or adjustments to the following to account for variability:

    a. rental income, overtime income, student allowance, boarder income, overseas income

    b. revolving credit contracts, home loan debt, home loan flexible facilities, credit card repayments and overdraft repayments.

119. Another way of applying a buffer is to adjust expenses where the customer declaration is lower than the benchmarked value. One lender is comparing benchmarkable expenses against internal benchmarks in all cases. Most bank lenders and all non-bank lenders have also indicated continued use of benchmarks, which are statistically modelled, for living expenses. In all cases lenders take the higher value for the expense assessment.

120. Importantly, following the changes, many lenders are applying buffers and adjustments in addition to reasonable surplus requirements, even though only one of these is required under the regulations to address the risk of overestimation/underestimation of income/expenses (respectively).

3.3 Concerns raised about the changes and the implementation

121. Lenders and other stakeholders have shared both general and specific concerns about the interpretation and implementation of CCCFA changes. Key concerns from our meetings and correspondence with lenders are set out below and expanded on in more detail in the remainder of this chapter.

SUMMARY OF CONCERNS RAISED BY LENDERS AND OTHER STAKEHOLDERS

- The prescriptive nature of the affordability assessment requirements is limiting lender discretion to adjust expenses and apply exceptions.
- Lack of scalability under the new Regulations is limiting lender discretion to take into account different kinds of consumer credit contracts or changes to existing contracts.
- Liability settings are contributing to conservative behaviour according to lenders.
- The changes may be adversely or disproportionately affecting certain borrowers and borrowing behaviour.
- Changes to how expenses should be estimated is resulting in overestimation, unnecessary inquiries, and increased processing times.
- Changes relating to the use of reasonable surplus are leading to conservative estimations of income and expenses.
- Some lenders are concerned about the calculation of revolving credit contracts in the Regulations.
- Stakeholders believe there is insufficient guidance and support for implementation.

122. The concerns raised below are from the 32 organisations we have interviewed as part of our investigation into the initial impacts of the recent CCCFA changes. This included 17 lenders, four consumer advocates and financial mentoring groups, four industry organisations, four credit reporting agencies/software providers, two dispute resolution schemes, and an independent regulator. Again, it is important to note that the concerns raised below are not representative of the entire industry.

123. During the investigation, some stakeholders raised concerns that relate to other parts of the CCCFA which are not part of the recent changes – e.g. provisions introduced in 2003 or 2014. We have not included these concerns as they are outside of the scope of this report.

3.3.1 General concerns raised about the changes

3.3.1.1 The prescriptive nature of the new affordability assessment requirements is limiting lender discretion to adjust expenses and apply exceptions

124. Most lenders and some stakeholders are concerned about the impact the new Regulations and the Code have had on the ability of lenders to exercise discretion in the assessment of credit applications. In general, stakeholders consider the level of prescriptiveness in the Regulations and the Code severely limits the discretion of lenders.

125. Most lenders consider the new requirements on how to assess likely relevant expenses outlined in regulations 4AK to 4AN do not leave room for discretion for lenders. Lenders consider this leads to conservative estimations of likely expenses, and that this is not fit for purpose in certain scenarios, including:

    a. to assume drawn credit will be there permanently in the calculation of BNPL expenses

    b. the inclusion of discretionary expenses the borrower would forego in financial hardship

    c. where lenders are making small material changes to an existing agreement.

126. These implications are discussed in more detail at 3.3.2, which addresses specific lender concerns.

127. Lenders are also concerned that the prescriptive requirements impact their ability to apply the exceptions provisions where they are making small material changes to existing agreements. As per section 9C(3)(a) of the CCCFA, lenders must make reasonable inquiries before making material changes to an existing agreement, as described in section 9C(8)(a) – 9C(8)(c). Some lenders noted this requirement is unduly onerous and unnecessary in certain scenarios. For example, a $500 credit limit increase to a credit card for a borrower where it is clear from previous records that it would not cause material hardship. Whilst lenders may apply the exception in regulation 4AG, many lenders have taken a conservative approach and said they are still inclined to conduct the full affordability assessment for making material changes to existing contracts under the current requirements.

128. Prior to the CCCFA changes coming into force, many lenders placed greater emphasis on borrowers' credit history for determining affordability. Lenders argue that credit history contains more important information, such as propensity to repay debt, which they claim is a more important factor when it comes to determining whether a borrower can repay a loan. Therefore, many lenders consider that more reliance should be placed on credit history as opposed to prescriptive assessment of previous income and expenses and assessment to determine likely future income and expenses.

3.3.1.2 Lack of scalability under the new Regulations is resulting is limiting lender discretion to take into account different kinds of consumer credit contracts or changes to existing contracts

129. Most lenders raised concerns over the lack of scalability of the CCCFA changes.

130. Whilst there are some differences in how the CCCFA changes apply to high-cost credit contracts, the CCCFA generally applies in the same way to all types of consumer credit contracts. Many lenders noted it is inappropriate for there to be no scalability between different kinds of consumer credit contracts or changes to existing contracts.

131. These lenders argue there are different levels of risk of financial hardship for borrowers depending on the type of product or changes they make to an existing contract. Therefore, they suggest lenders should not be required to conduct the full extent of an affordability assessment where there is a lower risk to borrowers. The requirement to conduct a full affordability assessment for certain kinds of products, or to the same extent for certain products, is, in some lenders' views, disproportionate to the risk of the product.

132. These lenders have also expressed concern that the lack of scalability and discretion may be having adverse impacts on certain borrowers by limiting lender discretion. They consider that it is unreasonable for borrowers with a good history of repayment to be subject to suitability and affordability assessments for low-risk credit contracts. For example, a borrower with a good credit history would be subject to the same process for a $500 increase to their credit card limit as they would be for a $1 million dollar home loan. Lenders noted this is disproportionate and there should be greater scalability or flexibility to allow lenders to apply discretion. One lender also said the lack of scalability is impacting certain subsets of borrowers, such as those who are self-employed as they may have difficulty in demonstrating income.

133. Some lenders hold the view the lack of scalability is not in line with the policy intent. This is to say that, if the purpose of the CCCFA changes is to target predatory lending and reduce problem debt and financial hardship, then it should specifically target certain kinds of lending and/or certain types of lenders which cause this, as opposed to applying to all consumer credit. Some lenders would like to see this concern addressed through the allowance of scalability between different kinds of consumer credit products, for example in the nature of the product, and/or value of the product, and/or the relative risk of the product.

3.3.1.3 Liability settings are contributing to conservative behaviour according to lenders

134. The 2019 amendments to the CCCFA brought into effect a regime with greater penalties and liability, the purpose of which was to deter non-compliance and increase protection for borrowers. This regime includes civil pecuniary penalties, statutory damages and expanded injunction orders for breaching, or assisting in the breach, of a range of provisions in the Act. Under this regime, there are penalties of up to $200,000 for an individual and $600,000 for a body corporate.

135. Most lenders expressed concern about the penalties and liability regime. These lenders consider the liability upon senior managers and directors is excessive, and that the increased risk is leading them to behave more conservatively. Lenders consider that, in combination with other more specific concerns raised about lack of clarity and reporting use of the exception discussed below, lenders are cautious about breaching provisions in the CCCFA.

136. Some lenders hold the view that the restriction on indemnities under section 107D is unjust and that the regime should allow greater protections for senior managers and directors through the allowance to indemnify themselves against liability.

137. Some larger lenders argue the penalties and liability regime disproportionately impact them since they have a greater scale of operations. They argue that since there are more components to their operations, for example, the inclusion of various departments in processing credit applications, there is greater burden for them to ensure all their operations are compliant with their due diligence duties prescribed under 59B of the CCCFA.

3.3.1.4 The changes may be adversely or disproportionately affecting some borrowers and borrowing behaviour

3.3.1.4.1 It may be more difficult to provide emergency support to vulnerable consumers

138. Some lenders argue it is more difficult to provide support to vulnerable consumers through emergency credit. Emergency credit is when consumers require credit expeditiously due to unforeseen circumstances. If a consumer needs to pay for utilities and requires emergency credit, they may be declined if they fail to reach the reasonable surplus threshold as part of the affordability assessment. According to some lenders, this is problematic as it may cause hardship.

3.3.1.4.2 Changes may be adversely impacting asset rich borrowers

139. Many lenders have expressed concern about how affordability assessments have been designed. More specifically, some lenders hold the view that it is inappropriate to only take

into account relevant income and expenses, and that this could be adversely impacting borrowers who are asset rich. One lender stated that the Regulations ignore a borrower's asset position, and that this is inappropriate as it does not adequately reflect affordability. An industry group stated that their lenders were declining borrowers with $15 million in assets.

140. Conversely, many consumer protection advocates view the focus on relevant income and expenses as appropriate. Under the previous regime, the guidance in the Code focused on satisfaction that the borrower could make payments under the agreement without undue difficulty, as well as meet necessities and other financial commitments without having to release security or assets, other than those the borrower was willing and intending to dispose or realise the value of. Consumer protection groups have shared the view that the new prescriptive regulations provide thorough assessment that gives lenders a full picture of the consumers financial position, where previously affordability could have been overestimated.

3.3.1.4.3 The restrictive and onerous nature of new lender processes may drive changes to borrowing behaviour

141. While we have not seen evidence of this yet, a few larger banks and non-bank lenders are concerned that the changes to their processes, which have made them more stringent and onerous, may be pushing borrowers towards less responsible lenders. Some of these larger banks and non-bank lenders argue that this is having the opposite of the intended effect as it is leading borrowers towards loans with higher interest rates, or loans which they are otherwise ineligible for.

142. There is concern from consumer advocacy groups and financial mentors that the stricter requirements on personal loans are contributing to an increase in the use of alternative forms of credit, such as BNPL. This is causing concern, as they are seeing problem debt occurring through BNPL, with one financial mentoring group saying they are seeing a similar kind of problem debt with BNPL as they previously saw with high-cost loans.

3.3.1.4.4 Changes may be reducing access to consumer credit used for investing in business

143. Whilst the CCCFA does not directly apply to business lending, some stakeholders have said the changes may be having indirect impacts on small business.

144. Small business owners have the option to use a variety of business loan types, terms and structures to finance their business. However, MBIE has been told that borrowers who use credit for the purpose of investing in a business are often subject to the same processes that lenders apply to consumer credit and are therefore being adversely impacted by CCCFA changes that restrict access to credit. We have heard that this is a particular issue where borrowers obtain business credit secured over their home.

145. As a result, the CCCFA changes which place tighter restrictions on consumer lending have generated concerns about reduced access to credit that is used for the purpose of investing in a business. Financial institutions did not provide quantitative evidence about the extent to which this is happens. There is evidence of at least one lender directing business owners towards business loan processes rather than consumer finance processes.

3.3.2 Specific concerns raised in relation to the implementation of new requirements

3.3.2.1 Changes in the process of what and how expenses should be estimated is resulting in over-estimating expenses and unnecessary inquiries and increased processing times

3.3.2.1.1 Lenders have concerns about overestimating expenses

3.3.2.1.1.1 Calculation of likely relevant expenses under regulation 4AF

146. As outlined at 3.2.2.1., lenders changed their processes to capture a wider range of expenses in a more granular level of detail to reflect the new requirements in 4AE. Most lenders raised concerns that the category of listed outgoings prescribed in regulation 4AE drives higher expense estimates by capturing outgoings that are not expenses (e.g., savings and investments under paragraph 'd') and capturing new discretionary components that would not have been captured prior to the changes.

147. Lenders have also raised concerns that the implementation of these new requirements has, in some cases, resulted in double counting of certain categories of expenses which leads to higher expense estimates. For example, capturing savings under paragraph (d) and also when drawn on for personal expenditure.

148. Furthermore, for those lenders still relying on customer declarations in the first instance, expense capture requirements prescribed by 4AE and 4AK are leading to customers declaring more than they would have done previously, often above the benchmarked level. This means there could be an overestimation of expenses where borrowers indicate they will continue discretionary services that (if hardship arose) they would be prepared to forgo.

149. As outlined earlier, most lenders, in accordance with regulation 4AK, use recent bank transaction records to estimate some categories of likely expenses (with or without also asking the borrower to declare expenses). Most of these lenders are concerned they are not able to apply discretion and adjust expenses down appropriately (e.g., by asking the borrower whether they will forgo discretionary expenses and discretionary components of expenses) to reflect where borrowers are likely to cut back expenses. According to some lenders bank transactions tend to overestimate likely living expenses by including discretionary components the borrower would forego in financial hardship.

150. More broadly, most lenders and a few other stakeholders were sceptical of the accuracy of using past expenses to determine likely future expenses. Many brought up the fact that a borrower's expenses can vary depending on the time of year or due to unforeseen life events. For example, during the Christmas period, a borrower's expenses may increase for Christmas, New Year's, and holiday travel, but this is not representative of usual expenses. Many lenders also expressed that in estimating likely expenses, there is little discretion for them to take into consideration a borrower's willingness to cease certain expenses once credit is drawn.

151. One lender raised concern that the second stage of estimating likely expenses in regulation 4AM is inappropriate. More specifically, where a lender has already captured the expenses through statements or other reliable information, the lender will already have verified the information in detail as part of the requirements of Regulation 4AK(2)(a)(ii) and (iii) and is unlikely to be able to verify the information further (and noting not all expenses are benchmarkable).

152. Furthermore, one lender noted that the requirement to use the higher of the initial estimate and benchmark for benchmarkable expenses prescribed in 4AM(2)(b) is not appropriate for all circumstances. They consider this to be the case because, when asked, borrowers may overstate their expenses, or a borrower may legitimately have lower expenses than the benchmark.

153. The latter two concerns may be resultant of misinterpretation of obligations, given that where the lender has made an initial estimate of likely expenses using transaction records under 4AK(2)(a)(ii) they are not required to verify or benchmark under 4AM unless there is a risk that the initial estimate materially underestimates relevant expenses.

3.1.1.1.1.1. Calculation of revolving credit contracts under regulation 4AL

154. Regulation 4AL(2)(a) and (d) state that a revolving credit contract debt expense must be determined as if the borrower will make regular monthly payments based on the credit limit within a reasonable period. Many lenders consider that this can lead to issues when applied to certain kinds of credit contract debt expenses.

155. For example, one lender said that where borrowers are using BNPL, it is difficult for them to collect and verify it under the current design of expense categories. The lender expressed they must assume drawn credit will be there permanently, whilst it could only be there for a short period of time. In turn, this can lead to an overestimation of expenses, according to this lender. For example, a BNPL limit of $1,000 combined with 6 weekly payments would (using the limit and number of payments) equate to $167 per week.

156. A lender provided another example where the affordability calculations can potentially double or even triple count the same item, resulting in overly conservative calculations. For example, lenders make an allowance for it under the BNPL facility of the expense calculation, then the customer could be including it in their estimate for personal expenses, and if the BNPL payments are linked to the borrower's credit card then it is also being included in the credit card repayment calculations. According to this lender, this has led them to overly conservative estimations of revolving credit contract expenses.

157. Regulation 4AL(2)(b) prescribes how lenders must calculate expenses for credit cards. One lender considered that it was impractical to estimate the minimum required payment or amount sufficient to repay the credit limit within three years, as required by the regulations, without significant effort and delays for the consumer.[6] This lender also suggested it can lead to situations where a borrower's expenses are overstated where a borrower routinely repays their card each month without incurring interest.

3.3.2.1.2 Lenders have concerns about unnecessarily intrusive inquiries

158. Many lenders raised concerns that the category of listed outgoings prescribed in regulation 4AE(d) results in intrusive inquiries into whether the borrower is willing to cease various

[6] Regulation 4AL(2)(b)(ii) provides that where this information is not readily accessible, an estimate of 3.8% of the credit limit can be used instead.

regular expenses. This is because the wider range of discretionary components captured by the new definition require more clarification and discussion.

159. Another concern was raised in relation to regulation 4AK where lenders feel as though they need to make excessive inquiries into discretionary living expenses to ensure they have accurately captured them. Many lenders appear to be asking the borrower about living expenses and also attempting to reconcile living expenses from bank transactions records. This results in unnecessary (and unintended) effort, and invasive inquiries of borrowers who are asked to explain bank transactions.

160. Furthermore, under regulation 4AK(2)(b), lenders are required to ensure that information is "obtained in sufficient detail to minimise the risk of material expenses being missed or underestimated to an extent that is material to the estimate." This obligation is driving in-depth review of statement information or other documentary evidence by most lenders to ascertain whether any expenses have been missed or underestimated to any material extent.

161. According to some lenders, where the initial estimate is based off a borrower's declared expenses, the verification process prescribed by 4AM involves comparing a borrower's declared expenses against statements/ transaction history and having a conversation with the borrower to discuss and reconcile any discrepancies between the two. These conversations focus on discrepancies for underestimated expenses, undeclared expenses, or overestimated expenses, and can involve questioning whether certain expenses will cease when credit is drawn, or why expenses were undeclared. Lenders who shared this concern said that borrowers are finding these conversations in estimation of likely expenses unduly intrusive and frustrating.

162. Many lenders feel as though the regulations require them to inquire into certain kinds of discretionary expenses, such as health, or other personal expenses, which can be offensive or uncomfortable for borrowers. Lenders have disclosed that they found these conversations difficult as they can become, or can be perceived as being, interrogative and adversarial, and can cause strain on the relationship between the lender and borrower. The strain on relationship is particularly problematic for lenders who have close personal relationships with longstanding borrowers, according to these lenders.

163. Many lenders are also concerned that they are having to follow up with consumers to request additional information which is onerous for consumers. One lender stated that they are now needing to have around four to five touch points between them and the borrower to request and verify information.

3.3.2.1.3 Lenders are concerned that the changes are leading to increased processing times

164. At the time lenders were interviewed, all lenders indicated their processing time for applications on all products had increased by 50% or more following implementation in accordance with the CCCFA changes.

165. Process changes to capture a wider range of expenses in accordance with 4AE are increasing the time taken to conduct an affordability assessment. This can either require the lender to review more transactions where they are using bank records or require customers to spend more time accurately declaring expenses.

166. Furthermore, the practice of relying more heavily on bank transactions and obtaining information in a higher level of detail can increase processing time where discretionary components trigger a manual review of 90 days of bank statements. Additionally, the use of detailed transaction history can subsequently trigger an increased number of customer inquiries which delay the lending decision.

167. Lenders are also having to verify and benchmark a wider range of expenses under 4AM, resultant of 4AE. This increases processing times as lenders are required to have more conversations with the customer about whether expenses are material, as well as require the customer to provide more information than prior to the changes.

168. Another concern raised by some lenders in relation to 4AM is that there are some categories of expenses that cannot be verified or benchmarked. For example, some lenders brought up the example of certain spending behaviour among borrowers, such as those who choose to withdraw cash for certain expenses, and that this makes it difficult and/or time consuming to verify certain expenses.

169. However, following implementation, further adjustments to on-boarding processes, resourcing familiarity with new frameworks and consumer awareness appear to be reducing processing times. The introduction of new systems and processes necessitates a learning period, and we expect reduced concerns about processing times in the future.

3.3.2.2 Changes relating to the use of a reasonable surplus is leading to conservative estimations of likely income and expenses

170. When conducting an affordability assessment under regulation 4AF(2)(b), lenders must ensure there is a reasonable surplus and/or buffers and adjustments to address the risk that income may be overestimated, expenses underestimated or that the borrower might need to incur other expenses. Many lenders raised concerns that the way in which they are required to apply the reasonable surplus leads to overly conservative estimate of income and expenses, and therefore the decline of loans which would otherwise be affordable.

171. Prior to the changes, most larger bank lenders used a reasonable surplus to inform lending decisions. However, the reasonable surplus which was used previously was generally dependent on the product type and acted as a further buffer to ensure the loan could be repaid without substantial hardship.

172. Following the changes, lender processes have been designed to strictly require a standard reasonable surplus for all products even where:

   a. buffers have already been applied for variability in income (through discounting) and expenses (through applying benchmark values to benchmarkable expenses)

   b. there are mitigating factors such as excellent borrowing history or a strong asset portfolio, because lenders are unsure how to incorporate these into the expense assessment.

173. The impact on borrowing is evidenced by one case study shared by lenders regarding an application for a new credit card with a $5000 limit. The borrower previously had a credit card

with a $27k limit with the lender. The borrower had a strong credit history and no missed payments. The borrower also had approximately $2.3m in assets and approximately $800k in liabilities. However, after the application of buffers and benchmarks, the borrower was declined as they failed to meet reasonable surplus requirements before the addition of the new credit card commitments. The application was escalated to a centralised team and analysed based on the purpose, assets and future use of debt, but still declined.

174. One lender argues that the test under 4AF(2)(b) goes beyond just ensuring that a borrower is not going to suffer substantial hardship, and that it also ignores industry practice where substantial buffers already exist within affordability assessments through the use of:

    a. mortgage test rates that are materially higher than actual mortgage interest rates

    b. haircuts applied to other sources of income, and

    c. the use of benchmarks expenses where these are higher than declared expenses.

175. The way in which some lenders have designed their income and expense estimate process means they are stacking buffers on top of one another. This is problematic because it contributes to overly conservative estimates.

176. Some lenders are sceptical of the concept of a reasonable surplus altogether. Two lenders who claim to have conducted analysis on the relationship between borrowers having a reasonable surplus and repayment behaviour found no relationship between the two. This is to say, according to these lenders, that there is no correlation between a borrower's surplus and probability to default.

177. Another lender argued that the requirement to have a reasonable surplus does not account for differences in spending behaviour, and that, for example, certain borrowers choose to spend any surplus in their balance when it is available for the sake of spending it. Thus, the application of reasonable surplus in these instances may be inappropriate or misguided.

3.3.3 Concern about the level of guidance and support for implementation

178. There were a variety of views on the guidance and support for implementation for the CCCFA changes. In general, banks have told us they were able to draw upon their internal resources to appropriately apply the government guidance and support. In comparison, non-bank lenders and some other stakeholders have struggled to interpret and apply the information provided in the existing guidance and support.

179. Many lenders and other stakeholders noted the existing guidance and support is insufficient to enable them to implement or utilise certain aspects of the CCCFA changes. The concerns with existing guidance and support span several areas, including:

    a. estimating likely income and expenses

    b. applying the exception

    c. the penalties and liabilities regime

d. records of inquiries.

180. Whilst a few stakeholders consider there is a lack of training to support lenders, consumers, and financial mentors, and/or that the current training is inadequate, the majority of issues stakeholders have with the guidance and support are targeted towards the Code.

181. The Code is made under the CCCFA to provide guidance on how to satisfy the responsible lending requirements contained within the CCCFA. The Code is intended to make it easier for lenders to determine what their obligations are and how to meet them.

3.3.3.1 Estimating likely income and expenses under regulations 4AJ and 4AK to 4AN

182. A key area of concern for lenders is the lack of guidance for estimating likely income and expenses, as prescribed under regulations 4AJ and 4AK to 4AN. Some lenders think the examples for estimating likely income and expenses in the Code are either too simplistic or that they fail to provide 'real-world' examples for certain situations. These lenders would like to see different examples provided in the Code. One stakeholder stated that there is a lack of guidance about proportionality, and how far lenders need to go into investigating expenses. Some lenders shared they would like further guidance on how to treat certain kinds of income and expenses.

183. One stakeholder said that the lack of differentiation between types of consumers within the affordability and suitability assessment guidance is inappropriate, given affordability can differ between different segments of consumer groups.

184. Another concern raised was that the definition of what time period 'recent' refers to under regulation 4AK(2)(a)(iii) is unclear as it is not defined in the Regulations or the Code. This has led to this lender approximating that 'recent' refers to that of the 90-day time period described in regulations 4AM(2)(a)(i). However, this lender argues that the use of 90 days is inappropriate for certain credit products such as home loan conditional approvals which expire after 90 days requiring them to reconduct a full affordability assessment if a borrower has not found a home within this time.

185. Under regulation 4AJ, lenders must now estimate the borrower's likely income using recent and reliable information they hold about the borrower's income and confirm with the borrower that this is accurate. One stakeholder considers there needs to be additional guidance on the appropriate time period for examining the borrower's likely income, and when further investigation is required. They raised the point that a borrower's income can fluctuate over time and therefore, depending on the time period a lender examines, there is the possibility of misestimating a borrower's likely income. For instance, if a lender uses a 90-day time period wherein a borrower has worked an unusual amount of overtime, then this may not be representative of the borrowers usual likely income, or reflect their likely income for the period of the loan.

3.3.3.2 Application of the exception in regulation 4AG

186. Regulation 4AG provides an exception to the general rule in regulation 4AF if there is no obvious hardship (the exception). It allows lenders to apply the exception to the full income

assessment if it is obvious the borrower will make the repayments without suffering substantial hardship and the agreement is not a high-cost consumer credit contract.

187. One stakeholder noted the example of an appropriate use of the exception in the Code is useful and provides a good indication of what it looks like when there is no obvious hardship. However, many lenders stated they have found it difficult to apply the exception.

188. There were a range of reasons why lenders found it difficult to apply the exception. Most lenders hold the view that the exception has a very high test with narrow scope. Some lenders stated that the legal advice they received warned against the use of the exception due to the potential risk of misuse, which, in conjunction with the record keeping requirements prescribed in the CCCFA and the Code could lead to severe penalties and liability. Lenders also told us that the guidance to inform lenders of when and how to use the exception is insufficient.

189. A few lenders said they are uncertain about what the term 'obvious' means. They also told MBIE that the example of 'no obvious hardship' in the Code is not useful because it is of a high-net worth consumer and is not representative of the full spectrum of consumers.

190. The extent to which the lender must make enquiries which are sufficient to establish no obvious hardship is also an area of uncertainty, according to one lender. This is problematic because the application of the exception, in their view, could require enquiries similar to that under the general rule at regulation 4AF, and this would defeat the purpose of an exception.

3.3.3.3 Application of penalties and liability regime

191. At the time lenders were interviewed, many argued the lack of guidance and information on how penalties and liability may be applied is leading to conservative behaviour by lenders. These stakeholders state there is a lack of clarity about enforcement, whether this differs between different kinds of breaches, where liability starts and ends and how liability is demarcated.

3.3.3.4 The industry is developing their own guidance and training

192. A few lenders, industry representatives, and a dispute resolution scheme, have developed their own guidance and training to support both their own and others' understanding and compliance with the changes. One industry representative has developed training modules for lenders and a consumer resource for their members about the CCCFA changes. A financial dispute resolution scheme has prepared an information resource on the changes for consumers and shared this across their networks and members prior to the Regulations coming into force. These information resources for consumers provide an explanation to consumers that it may take longer for them to access credit, they may get asked more questions, and they may not be approved for credit which they previously may have been approved for.

Chapter Four: Changes in the credit market since December 2021

193. This chapter sets out:

   a. the changes that have occurred recently in credit markets, and

   b. key factors impacting these changes and the likely contribution of the CCCFA changes.

194. We set out information about a range of factors that have been cited as potential influences on recent trends. Many of these factors, such as rising interest rates, cost of living pressures, and loan-to-valuation ratio (LVR) policy tightening, are expected to contribute to a slowdown in lending volumes and prices.

4.1 Key changes to the credit market

195. Below, we set out the data available on new lending volumes (amount and number of borrowers), credit applications, and rates of withdrawn applications and credit declines. This enables changes in new lending volumes to be decomposed into changes at different stages of the lending application process.

4.1.1 There has been a drop in mortgage lending volumes amid high volatility

4.1.1.1 Mortgage lending fell in dollar terms across all groups of borrowers

196. Figure 1 shows that new mortgage lending was $7.2b in March 2022. From December 2021 to March 2022, total mortgage lending fell in dollar terms compared to November 2021 ($9.1b) and compared to corresponding periods 12 months previously. Compared with 12 months earlier, lending in December 2021 fell 18%, January 2022 fell 27%, February 2022 fell 25% and March 2022 fell 31%. Mortgage lending has been highly variable over the past two years compared to earlier periods.

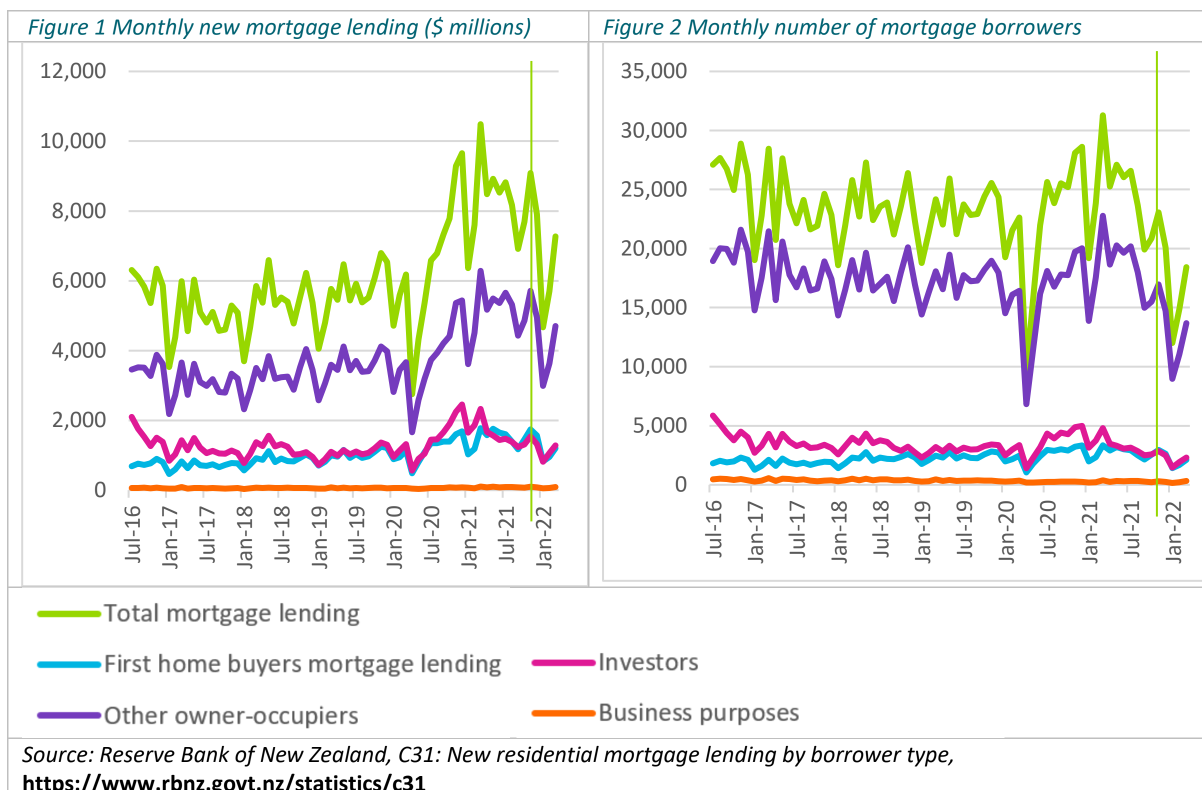


Figure 1 Monthly new mortgage lending ($ millions)

Figure 2 Monthly number of mortgage borrowers

Source: Reserve Bank of New Zealand, C31: New residential mortgage lending by borrower type, **https://www.rbnz.govt.nz/statistics/c31**

197. Mortgage lending fell across all groups of borrowers: first-home buyers, other owner occupiers, investors and businesses. Lending to first home buyers and other owner occupiers has fallen since December 2021, although less than mortgage lending. Lending to these two groups is regulated under the CCCFA. Compared to 12 months earlier, lending to first home buyers fell 7% in December 2021, 20% in January 2022, 19% in February 2022 and 32% in March 2022.

198. Greater falls were observed in respect of mortgage lending to investors (e.g. 46% and 51% in December 2021 and January 2022 respectively compared to a year earlier). Lending to this group is not regulated under the CCCFA, although we understand that some lenders apply the same processes to these borrowers as owner-occupiers. Investors are also expected to be impacted by tax changes first announced in March 2021.

199. A small portion of mortgage lending is for business purposes (also not regulated under the CCCFA, but may be subject to the same processes), which fell in December 2021 compared to the previous month but was 4% higher than the previous year. This was 25% lower in January 2022, 23% higher in February 2022 and 17% lower in March 2022 compared to 12 months earlier.

200. In addition to banks, a range of non-bank lending institutions (NBLIs) operate in the New Zealand mortgage market. These NBLIs, namely building societies, credit unions, and finance companies, are a small sector of the market, but have been showing exceptionally strong growth over the past year. NBLI housing lending rose 46.1% in the year to February 2022, which is the strongest growth since records began in 1998. There is no obvious impact from the CCCFA changes, with lending up $300m over the past three months. NBLIs are not subject to LVR restrictions, which have been tightened on banks over this time period.

4.1.1.2 Drops in the number of new mortgages were more pronounced

201. The number of mortgage borrowers (Figure 2) were down 30% in December 2021 compared to December 2020, but this appears to reflect the second half of 2021 generally being slow compared to prior years. January 2022 shows a stronger dip of 37% lower than January 2021 and this continued into February 2022 and March 2022, which were down 38% and 41% on February 2021 and March 2021 respectively. January 2022 had the fewest mortgage borrowers in the series except for during COVID-19 Alert Level 4 restrictions in April 2020.

202. The decline in the number of new borrowers is consistent with data received from credit reporting agencies on the number of new residential mortgage accounts, and data from individual lenders. Data from individual lenders show falls in mortgage lending to different degrees: for some lenders the drop has been to a level below that of April 2020, whereas others have seen lesser drops in new mortgage loans.

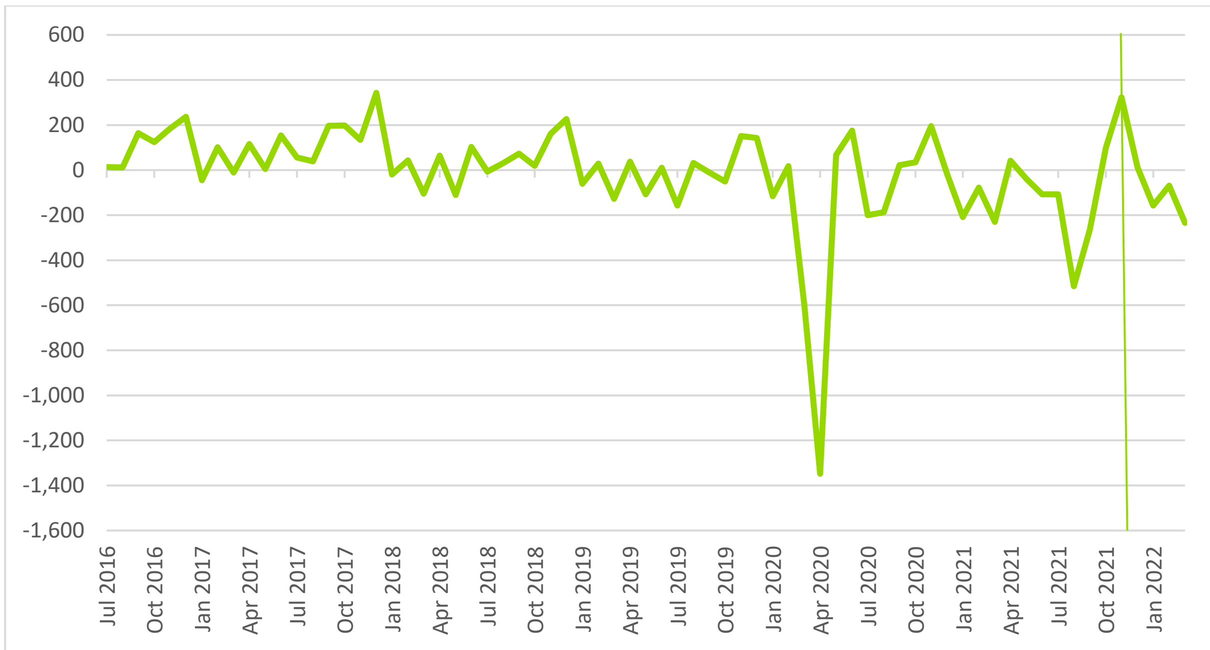
203. RBNZ data from *the LVR – New commitments* survey shows the number of mortgages fell across all mortgage types from November 2021 to February 2022. The number of new property purchases fell 35.4% over this period, while the number of top-ups to existing borrowers fell 35.0%, and the number switching to other lenders fell 41.9%.

4.1.2 There has also been a change in the volume of personal loans, credit cards and other consumer lending

204. The Reserve Bank does not collect data on new non-mortgage consumer lending. However, data is available on the total outstanding amounts owed to banks and significant non-bank lending institutions from non-mortgage consumer lending. The growth in this figure may give some indication of activity trends, as it reflects the amount of new lending and interest accrued, less repayments and amounts written off.

205. No trend is discernible in this data (Figure 3), with one-off falls in loan assets observed during Alert Level 3 and 4 in April 2020 and August 2021.

Figure 3 Monthly growth in non-mortgage consumer loan assets ($ millions)



Source: Reserve Bank, Registered banks and non-bank lending institutions: Sector lending (C5), **rbnz.govt.nz/statistics/c5**.

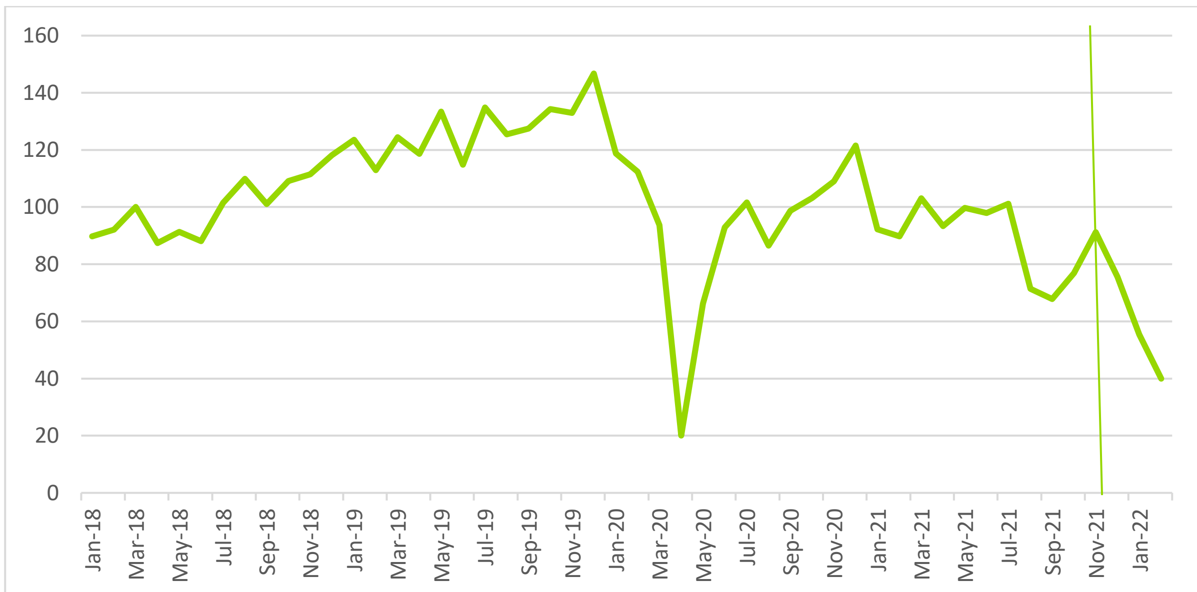
206. For individual types of lending, such as personal loans, credit cards and overdrafts, we use RBNZ data on total credit limits and outstanding borrowing and summarise information on new lending provided by credit reporting agencies and individual lenders.

4.1.3 There has been a drop in new personal loans

207. 'Personal loans' in this context refers to unsecured term loans for consumer purposes.

208. Credit reporting agency data in Figure 4 shows new personal loans fell in December 2021, January 2021 and February 2022 by 17%, 27% and 28% respectively against a year prior, similar to trends in home loans. New personal loans in general are below their December 2019 peak.

Figure 4 Monthly index of new personal loans



Source: MBIE calculations based on Equifax and Centrix data

4.1.4 There has been a drop in new credit cards

209. While credit card limit data does not show any sign of being affected by recent events, credit reporting agency data shows a significant reduction in new credit cards being issued.

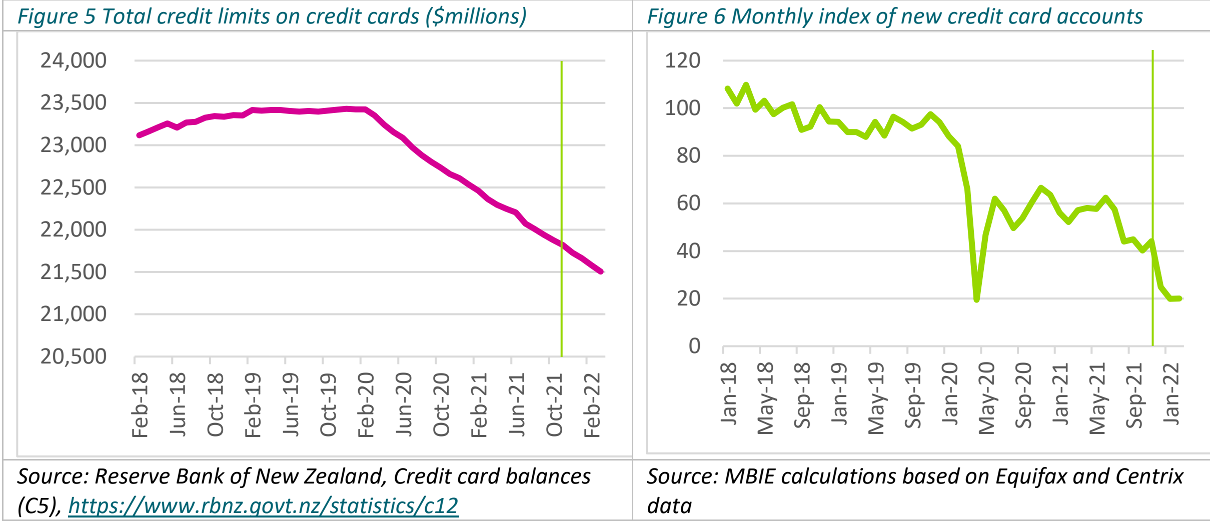


Figure 5 Total credit limits on credit cards ($millions)

Source: Reserve Bank of New Zealand, Credit card balances (C5), https://www.rbnz.govt.nz/statistics/c12

Figure 6 Monthly index of new credit card accounts

Source: MBIE calculations based on Equifax and Centrix data

210. Credit card limits fell around 0.3–0.4% each month between December 2021 and March 2022. However, credit limits have been steadily declining since February 2020, so the recent data continues a well-established trend. Credit limit utilisation[7] has also remained steady at around 27% of credit limits throughout the past four months.

211. Credit reporting agency data (Figure 6) shows new credit card accounts approximately halved during December 2021 to February 2022, compared to November 2021. Data from individual lenders shows that some saw falls in credit card approvals over August and September 2021 (coinciding with Alert Level 3 and 4) and a flattening thereafter. It may be that lenders who did not provide us with data experienced more substantial falls in new credit card accounts in December 2021.

4.1.5 Vehicle finance

212. Within NBLIs, there is a subgroup of firms that are focused in the vehicle lending sector to households. RBNZ data shows lending from this sector fell 0.5% in the year to February 2022. The stock of vehicle consumer loans has been relatively flat for the past 6 months and increased by $4.6m from December 2021 to reach $1,533.7m in February 2022. It is hard to discern if CCCFA changes have had an impact on vehicle finance loans at an aggregate level.

213. In contrast to RBNZ data, credit reporting agency data shows a marked decline in new vehicle loans from December 2021. This may signal that the amount of outstanding vehicle loans will fall in the coming months.

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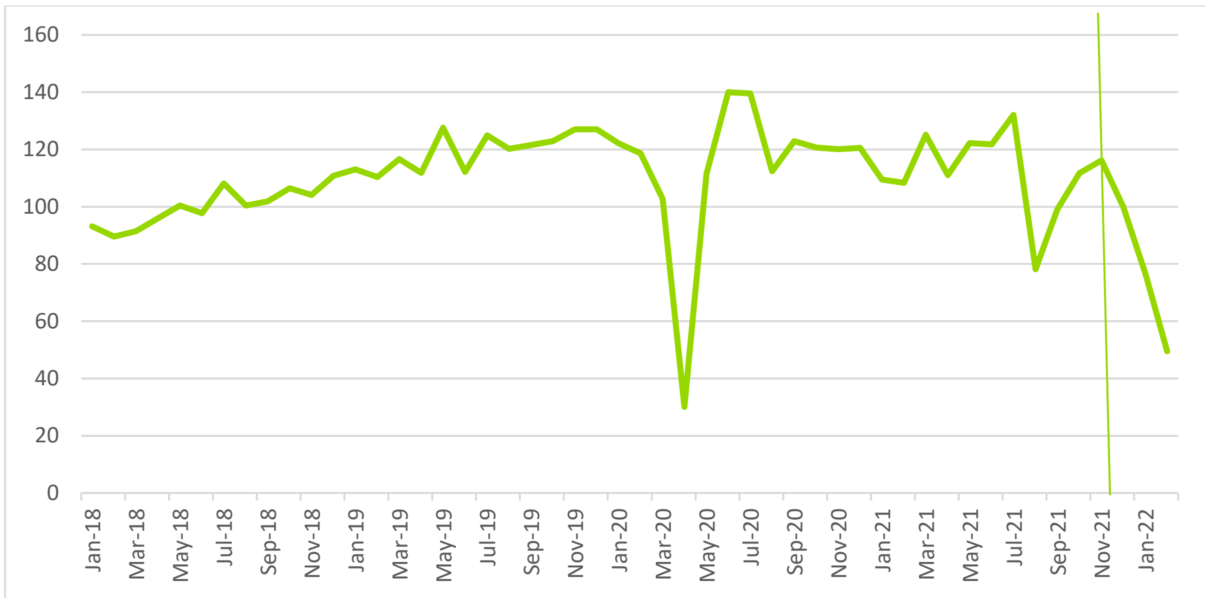
[7] Credit card utilisation is calculated as the ratio of total advances outstanding (or credit card debt) to total allowable credit limits.

Figure 7 Monthly index of new vehicle loans



Source: MBIE calculations based on Equifax and Centrix data.

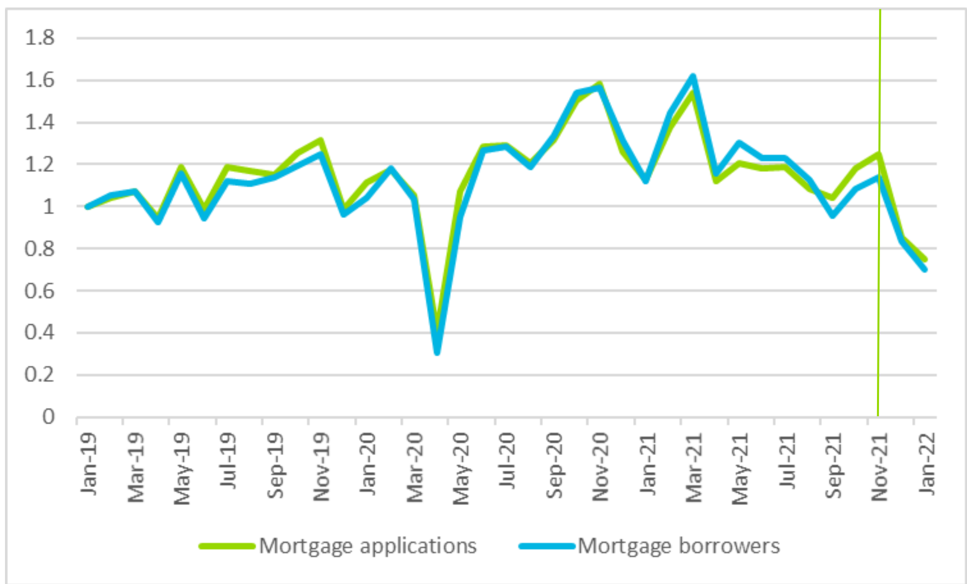
4.1.6 The number of lending applications and conversion rates has decreased

214. To better understand the drop in lending volumes, we deconstruct these into changes in applications, withdrawn applications and declines below.

4.1.7 Much of the decline in home loan volumes is attributable to a drop in applications

215. A major driver of reductions in lending volumes appears to have been a drop-off in applications. Figure 8 shows that, for home loans, the relative number of borrowers and number of applications track each other closely, and this continues in December 2021 and January 2022. Home loan volumes fell by 37% in December 2021 and 38% in January 2022 compared to a year earlier, and the majority of this drop was attributable to a fall in applications submitted, which were down 32% and 34% respectively.

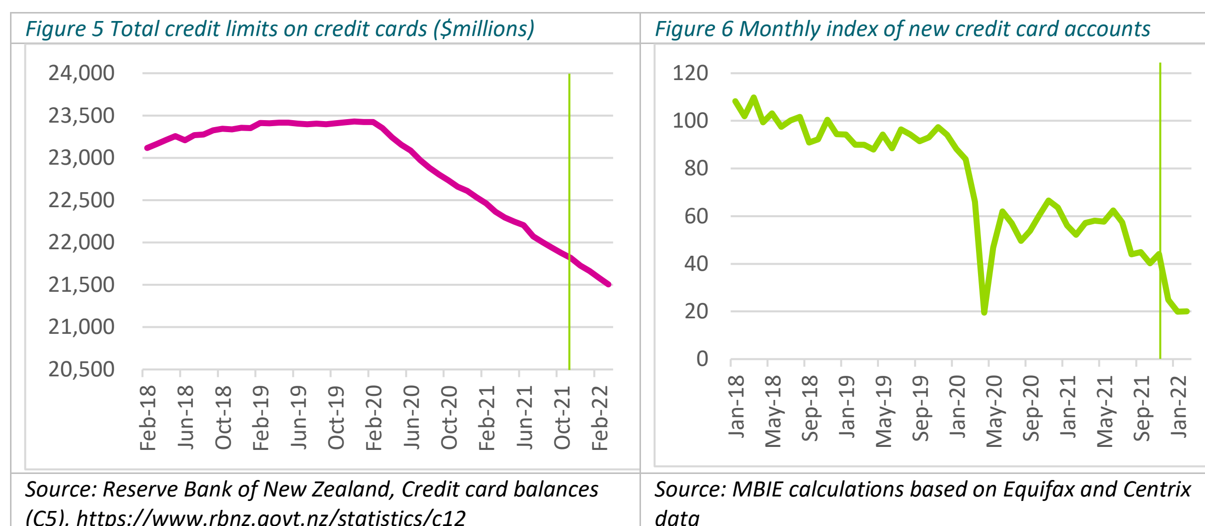
Figure 8 Indices of monthly mortgage applications and borrowers (January 2019=1)



Source: MBIE calculations based on data supplied by banks

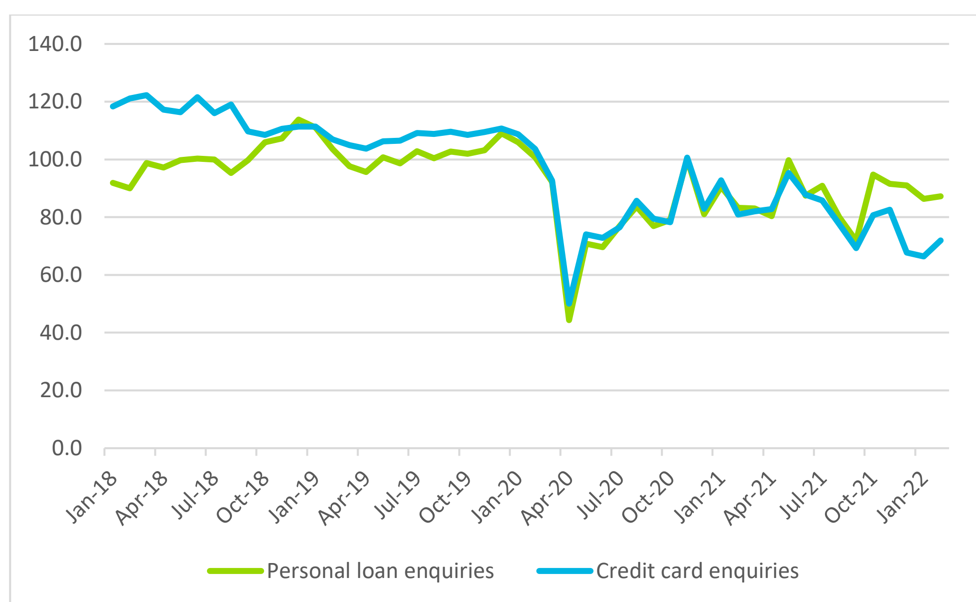
216. The limited evidence we have for other types of lending suggests a smaller relative contribution to a drop in loan volumes from a drop in applications over the past several months. Some banks have seen personal loan and credit card applications hold up, while others have seen falls. Credit reporting agency data suggests that overall credit card enquiries have fallen more than personal loan enquiries (Figure 9), perhaps reflecting the longer-term trend in credit card balances observed above.

Figure 5 Total credit limits on credit cards ($millions) | *Figure 6 Monthly index of new credit card accounts*



Source: Reserve Bank of New Zealand, Credit card balances (C5), https://www.rbnz.govt.nz/statistics/c12 | *Source: MBIE calculations based on Equifax and Centrix data*

Figure 9 Indices of credit enquiries



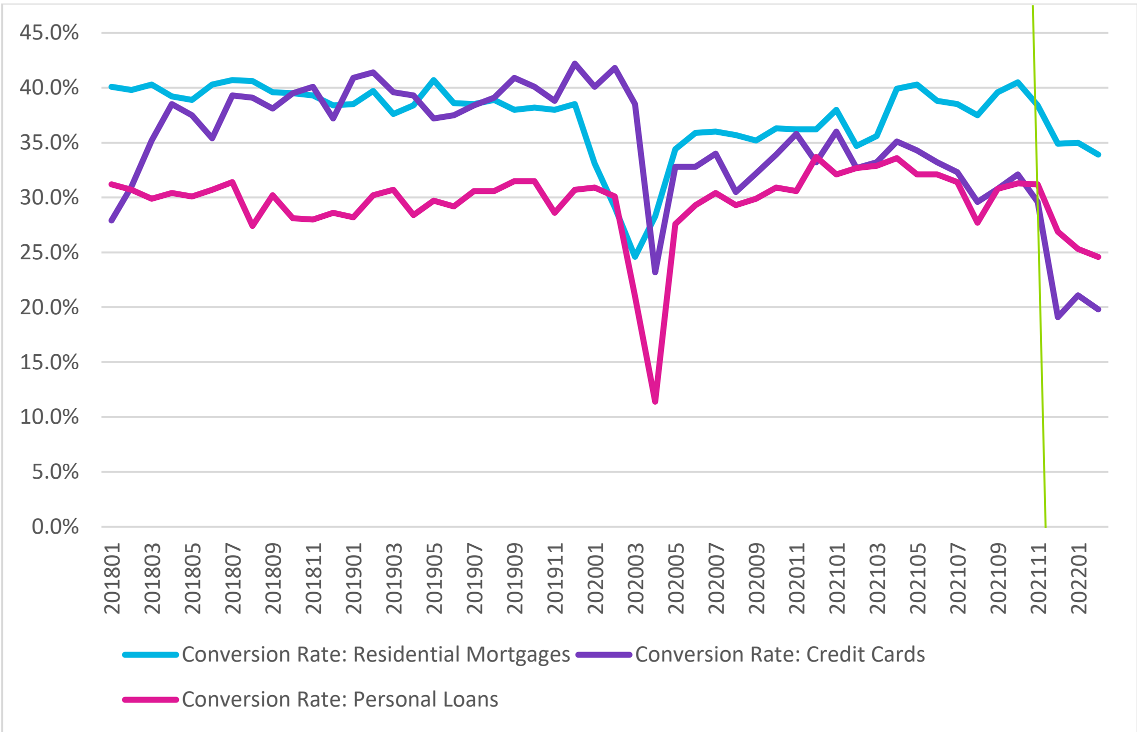
Source: MBIE calculations based on Equifax and Centrix data

4.1.8 Some portion of the reduction in loan volumes is attributable to more applications being withdrawn and declined

217. Rates of declines and withdrawn applications appear to have increased across a range of products since late 2021.

218. This is proxied by credit reporting agency data on the ratio of new credit accounts to credit enquiries (sometimes referred to as the ‘conversion rate’), shown below.

Figure 10 Ratio of new credit accounts to credit enquiries



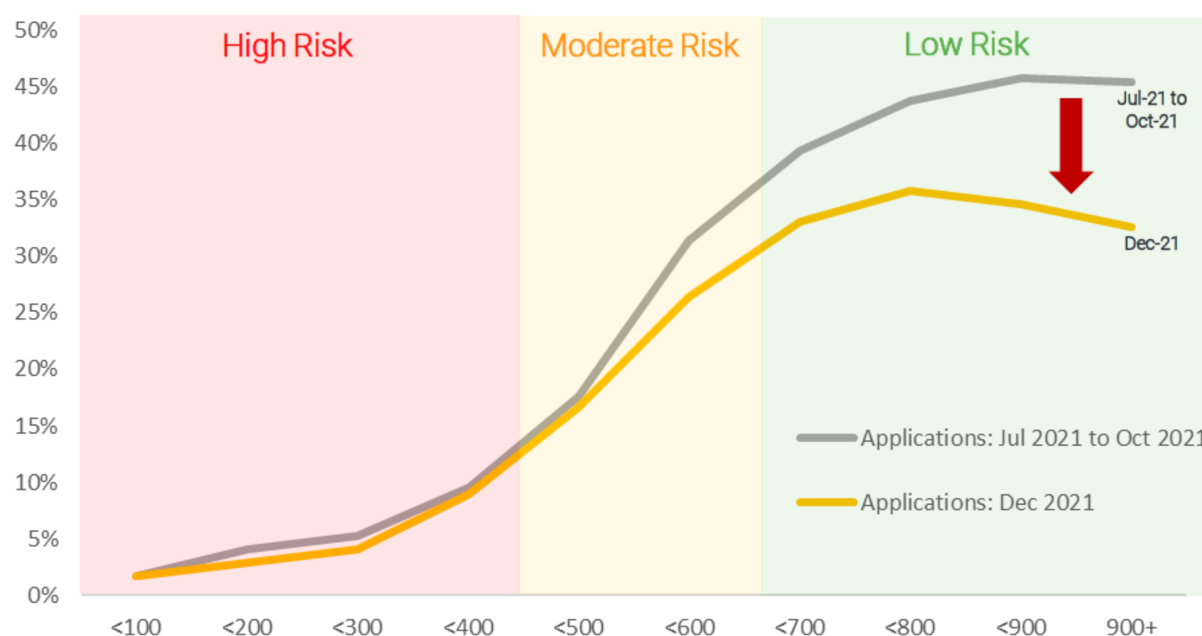
Source: Centrix

219. There is a high degree of variability across lenders as to how application declines and withdrawals have changed since the implementation of the CCCFA changes. Some lenders show no change to decline rates, or even decreases in loan declines, combined with decreases in withdrawn applications. Other lenders show increases in declined applications. These differences are likely related to different lender processes.

4.1.9 Declines in conversion rates have been largest for borrowers with higher credit scores

220. Data publicly released by Centrix showed that in December 2021, the largest fall in conversion rates was for borrowers with credit scores over 700, while borrowers with credit scores under 500 saw only a small fall in conversion rates.

Figure 11 Loan conversion rate by credit score



Source: Centrix

221. One interpretation of this data is that the CCCFA has impacted 'low-risk' borrowers, and less so 'high-risk' borrowers who are the presumed target of the CCCFA changes. This interpretation assumes that credit scores are a good proxy for loan affordability. It is also possible that it reflects some combination of:

    a. lenders screening out borrowers with lower credit scores and weaker repayment histories, regardless of loan affordability

    b. some lenders highly weighting credit scores and repayment history in credit assessments, in the absence of underlying affordability.

4.2 Contributing factors

222. There are several factors likely contributing to the changes in the credit market, including:

    a. seasonal trends – typically lowering mortgage lending volumes in summer months

    b. tightened Loan-to-Value Ratio (LVR) restrictions – lowering mortgage lending volumes from banks, mainly to first home buyers with low deposits

    c. global economic conditions – impacting New Zealand mainly via higher inflation and interest rates

    d. increases to the Official Cash Rate (OCR) and some wholesale and retail interest rates – expected to have a strong downward impact on demand for mortgage lending as households' ability to service their debt is reduced

    e. inflation and cost of living increases – reducing their ability and willingness to take on new and larger mortgages

f. house prices – remaining high but trending down, as the market cools and buyer attitudes shift

g. impact of COVID-19 on spending, saving and borrowing behaviour.

223. Overall, lending was trending down prior to the CCCFA changes coming into effect, with a variety of factors involved. Higher interest rates and international shocks are likely to have impacted house prices, and reduced lending volumes, at the same time as the CCCFA changes occurred. Interactions between all these factors can be expected to reduce lending volumes.

4.2.1 Seasonal trends in mortgage lending

224. There is typically a large seasonal fall in new mortgage commitments over December and January, driven by lower volumes as the holiday period affects turnover and leaves fewer working days for lenders. We would then expect a bounce back in February before returning to 'normal' in March. Data this summer showed larger movements than normal, with a record 41% fall in mortgage lending values in January followed by a 22.3% increase in February – the largest February increase since 2018.

Figure 12 Seasonality of lending over 2021

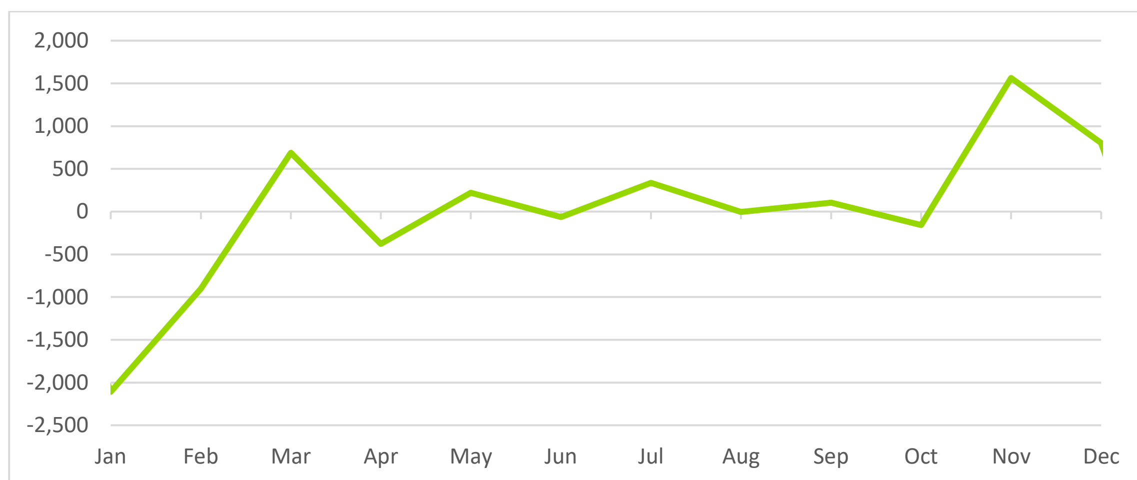
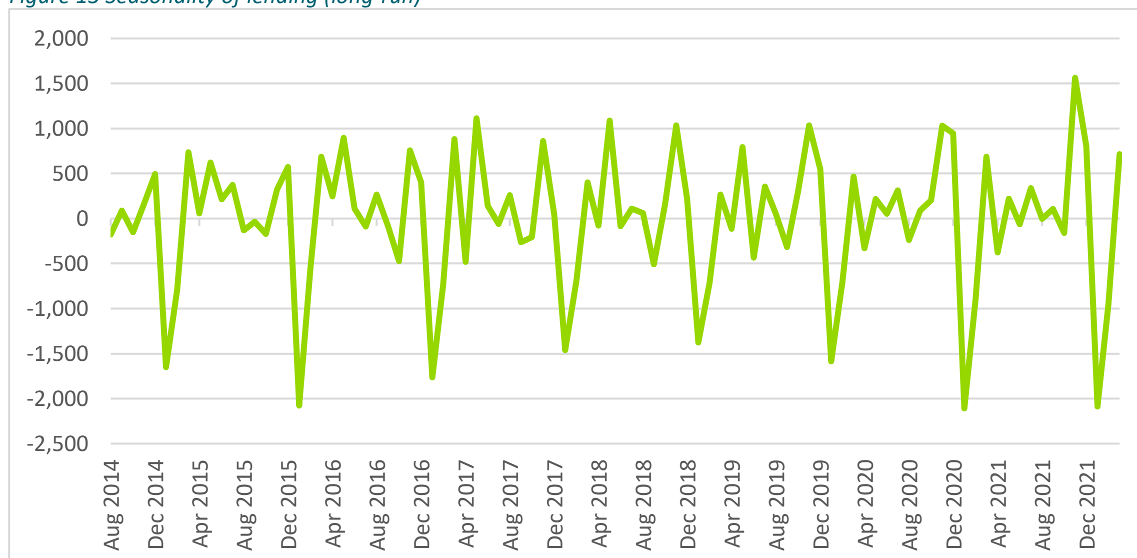


Figure 13 Seasonality of lending (long-run)



Source – RBNZ Analysis, X13 decomposition

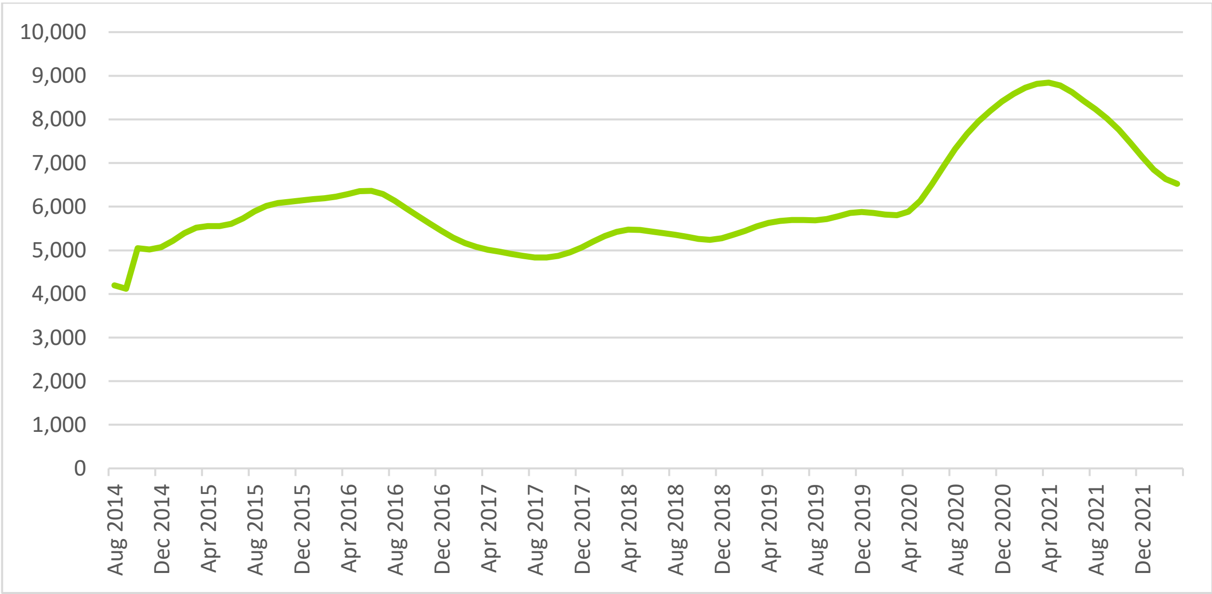
225. Looking at mortgage lending relative to expected seasonal trends, there was a higher level of lending in October and November 2021 than RBNZ Q3 seasonally adjusted 'steady state' forecasts (assuming all economic and policy variables remained constant) estimated. This was followed by lower lending levels than forecast estimates showed in December and January. This suggests some level of mortgage lending being brought forwards prior to 1 December.

Figure 14 New commitment value before exemptions - all banks

Source – RBNZ Analysis, X13 decomposition and forecast

226. When seasonally adjusted to better show underlying trends, this shows several years of relatively steady mortgage lending values, before rapidly increasing in 2020/21, then peaking and trending down over the latter part of 2021, and into 2022. Relevant factors from August 2021 included the onset of higher interest rates, the Alert Level 4 lockdown, and tighter LVR. speed limits.

Figure 15 Seasonally adjusted mortgage commitment trend ($ billions)



Source – RBNZ Analysis

4.2.2 Loan-to-Value Ratio (LVR) restrictions

227. LVR restrictions on owner-occupiers without investment property collateral were tightened from 1 November 2021. Previously, the restrictions allowed a maximum of 20 percent of new lending (by value) at LVRs above 80 percent (i.e. a deposit of less than 20 percent). Under the new tighter settings, a maximum of 10 percent of new lending is permitted at LVRs above 80 percent. Lending to borrowers eligible for Kainga Ora First Home Loans is exempt from the LVR restrictions, as is lending for new build properties.

228. Since the LVR restrictions were tightened, the share of high LVR lending to owner-occupiers has fallen as expected. In the three months prior to 1 November 2021, high-LVR lending to owner-occupiers accounted for 11.6 percent of lending to this group, while in the three months following 1 November 2021, high-LVR lending accounted for 9.8 percent. These figures are before exemptions.

229. The Reserve Bank estimates the impact of tighter LVR restrictions on overall credit availability has been modest, since high-LVR lending to owner-occupiers accounts for a small share of total lending. In the three months prior to 1 November, non-exempt high-LVR lending to owner-occupiers totalled $1.6b, which was 7.2 percent of total mortgage lending of $22.8b. In the three months following 1 November, non-exempt high-LVR lending to owner-occupiers totalled $1.2b, which was 5.7 percent of total mortgage lending of $21.7b.

230. Owner-occupiers with LVRs less than 80% were unaffected by the speed limit changes in November 2021, so trends over the November 2021 to February 2022 period should be more attributable to other factors. Lending to owner-occupiers with LVR less than 80% decreased 35.6% from November 2021 to February 2022. Part of this fall can be attributed to seasonal fluctuations usually observed over this period. However, the average November to February decrease for all owner occupiers with LVR less than 80% over the preceding four years was just 21.3%.

4.2.3 Global economic conditions

231. Globally, there are strong inflation pressures, leading to rising interest rates. Covid-19 continues to hinder supply chains, while increased vaccination rates across developed countries, combined with a simultaneous loosening of lockdown restrictions, contribute to demand outpacing supply. The war in Ukraine is also causing higher inflation across a wide range of essential goods.

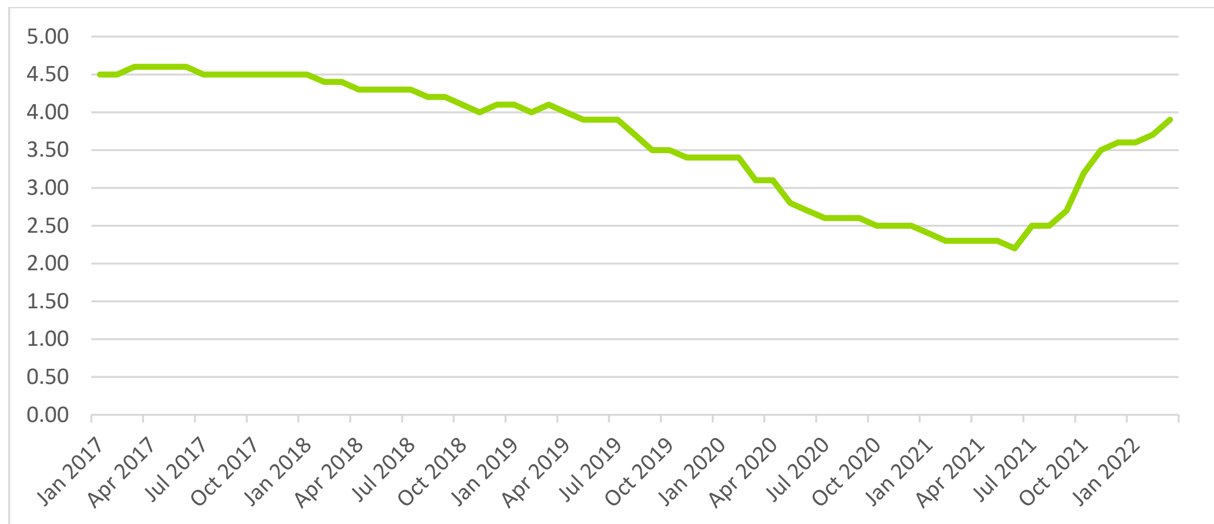
232. These factors and their impacts on lending are explored in more detail in the sections below. Taken together, we would expect these factors to contribute to lower lending volumes than would otherwise have been the case. New Zealand lenders are affected by these international factors, either directly when they source funding from offshore, or indirectly given the impact on the cost of domestic deposits. New Zealand banks with Australian parents are generally able to source international funding at lower rates than other New Zealand lenders, given their parents' and their own high credit ratings, but recent volatilities in the international markets driven by inflation fears and geopolitical developments have resulted in increases in the cost of funding across the board.

4.2.4 Increases to the Official Cash Rate (OCR) and some wholesale and retail interest rates

233. Rapidly rising interest rates are expected to have a large impact on house prices and lending capabilities. This will increase serviceability burdens on households.

234. The average 'special' 12-month mortgage rate rose from 2.53% in December 2020 to 3.59% in December 2021. Meanwhile, the median house list price (REINZ) has risen from $600,000 to $730,000. A large proportion of lending is conducted on a 1-year special rate.

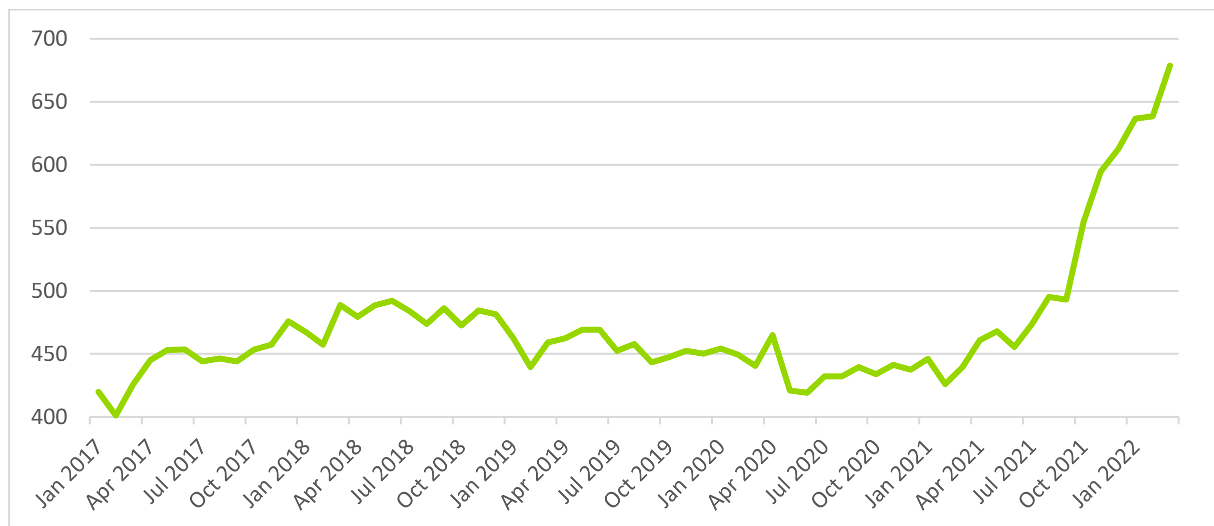
Figure 16 Average 12-month special mortgage rate (%)



Source – RBNZ

235. Rising interest rates will have impacts on repayment affordability in the short-term, as median home purchases in Dec 2020 had a weekly mortgage cost of $500 while a median home purchase in Dec 2021 has a weekly mortgage cost of $650.

Figure 17 Expected weekly mortgage on new 80% LVR median home on 12-month rate



Source – REINZ, RBNZ, RBNZ Analysis

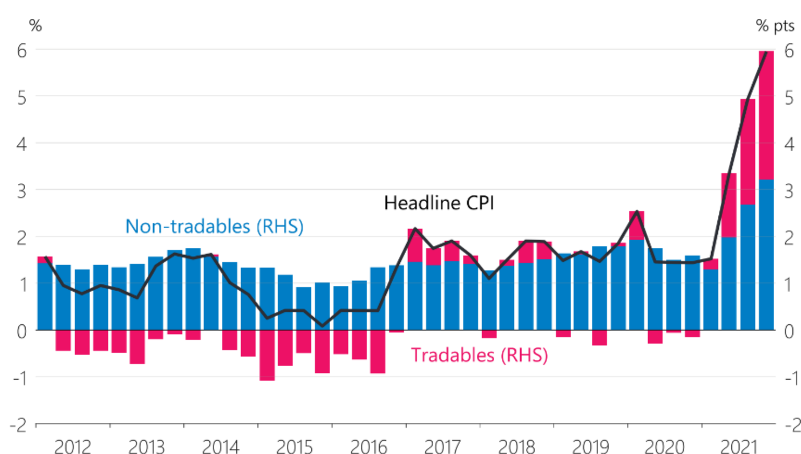
4.2.5 Inflation and cost of living increases

236. Annual CPI inflation was 5.9% in December 2021, up from 1.4% and 1.9% in December 2020 and December 2019, respectively. This is the highest inflation rate recorded since June 1990.

237. Sustained high inflation of essential goods and services such as transport, housing, and food, will increase households' ongoing costs and therefore reduce their capacity and willingness to borrow, strengthening headwinds for mortgage flows in the short to medium term. This is exacerbated by a comparatively lower labour cost index wage inflation of just 2.6%, while average hourly earnings were up only 3.8%.

238. High levels of imported inflation (tradable inflation) have contributed to the rapid increases in prices shown over 2021, particularly in transportation costs (oil/gas prices). As such NZ interest rates will have large exposures to overseas movements.

Figure 18 Contributions to annual CPI inflation



Source: Reserve Bank of New Zealand, Monetary Policy Statement February 2022, **https://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement**

239. Important components of higher inflation were:

a. Petrol prices contributed strongly to higher inflation, with an average quarterly price of 91 octane petrol of $2.45 per litre in December 2021, up 31% from $1.87 in December 2020.

b. Annual food price inflation was 6.8% in February 2022, up from 1.2% in February 2021, and is the highest level recorded since July 2011. This reflects the increased cost of inputs to agricultural production, i.e., fertilizer, labour shortages, supply chain constraints and transportation costs.

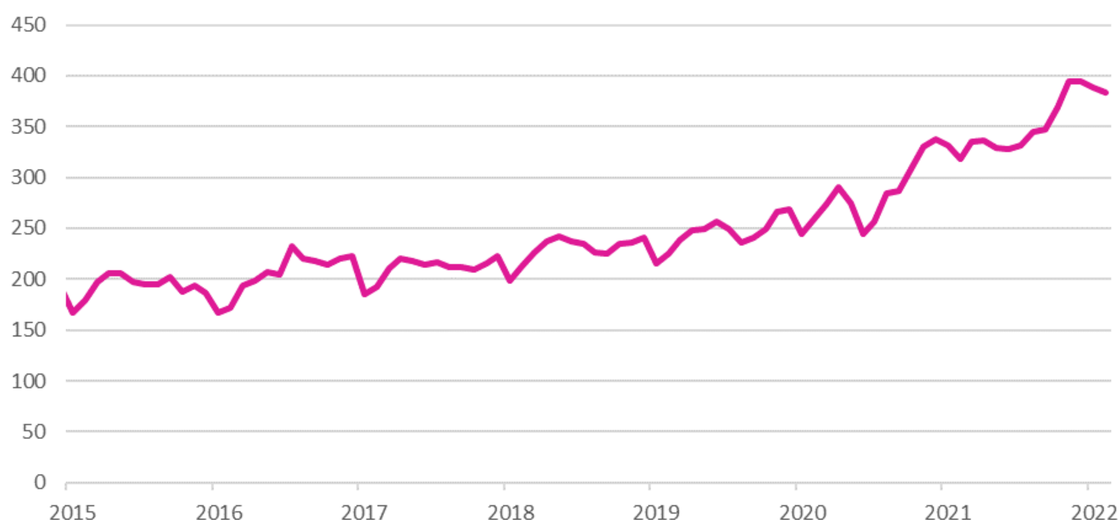
c. Annual rent price inflation in February 2022 was 3.6% based on the stock measure of rental property, which takes all dwellings into account. The more dynamic flow measure, which only includes dwellings with a new tenant in the reference month, recorded annual rent price inflation of 4.6%.

240. Based on the March 2022 quarter RBNZ Household Expectations Survey, respondents on average expect 1-year ahead inflation to remain elevated at 5.8%, the highest estimate recorded since the series began in 1995.

4.2.6 House price trends

241. Borrowers have taken on larger mortgages over time, as house prices have risen 74% since July 2016.[8]

Figure 19 Average new commitment size (including top ups and switching)



Source: RBNZ

242. However, a slowdown in house prices is now underway. The national REINZ House Price Index (HPI) has fallen 2.3% in the 3 months to February 2022. Year-on-year, the HPI increased 14.3% from February 2021 to February 2022. However, when compared to year-on-year increases of 19.9% and 23.3% in January 2022 and December 2021 respectively, a clear downward trend is emerging.

243. This emerging trend is strengthened by data from the February 2022 RBNZ Household Expectations Survey, in which 61.9% of respondents expect higher house prices in 12 months' time, down 19.5 percentage points year on year. The mean house price inflation expectation was just 5.1%.

244. Overall, cooling house price momentum, coupled with prices that remain high relative to incomes, can be expected to lead to reduced lending volumes. High house prices present a higher barrier and risk to borrowers and lenders if there is not a strong expectation of future capital gain.

245. Although fundamentals are weakening for housing, the fundamental risks to growth asset alternatives (such as stocks) are also weakening in a contractionary cycle, which may add buoyancy to the market even if volumes remain low.

246. Building consents remain high, as an ongoing supply-side response to the housing shortage. Current consents are unlikely to impact house prices in the short term due to the lag between consenting and production of the final unit.

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[8] Calculations based on CoreLogic House Price Index, July 2016–February 2022, **https://www.corelogic.co.nz/corelogic-house-price-index**

4.2.7 Impact of COVID-19 on spending, saving and borrowing behaviour

247. There is limited data at this stage to show the impact of the Omicron COVID-19 surge on spending, saving and borrowing behaviour.

248. RBNZ credit card data shows a seasonally adjusted fall in spending this year that coincides with the Omicron surge, but largely continues well established post-COVID-19 trends of lower credit card spending. Seasonally adjusted domestic billings on New Zealand issued cards were $3.5 billion in February 2022, down 3.2 percent from January 2022.

4.3 Contribution of the CCCFA changes to changes in the credit markets since 1 December 2021

249. Changes in consumer credit borrowing levels since the 1 December changes have been different across product types. As discussed in Chapter Three, the new affordability requirements introduced by the CCCFA changes are contributing to increased processing times, higher expense estimates and more in-depth inquiries into borrower expenses. Overall, this is driving increased withdrawals and declines for all types of lending.

4.3.1 Contribution of the CCCFA to drop in mortgage lending

250. The impact of the CCCFA changes on home lending loan levels has been moderate, due to the influence of other credit market factors that affect mortgage availability and serviceability.

251. There is evidence of a sharp drop in mortgage lending compared to previous years, with December 2021 being down 30% on December 2020.

252. Prescriptive application of new CCCFA regulations to all lending products means mortgage lending, for which banks already had relatively robust processes, is now subject to more restrictive affordability processes. As discussed below, the contribution of the CCCFA changes to declines in new mortgage lending was unexpected, as lenders were not expected to change relatively robust home lending processes to a material extent.

253. However, the other factors outlined in the section above are likely to contribute to reduced borrower demand. Reduced demand is driving lower new application levels for mortgage lending.

4.3.2 Contribution of the CCCFA to drop in personal loans and credit cards

254. The impact of the CCCFA changes to personal and credit card lending loan levels has been high compared to home loans.

255. Credit reporting agency data above shows new personal loans fell in December, January and February, similar to trends in home loans. New personal loans in general are well down on their December 2019 peak. Furthermore, while credit card limit data does not show any signs of being affected by recent events, credit reporting agency data show a reduction in new credit cards being issued.

256. Most credit market changes that are relevant to home lending do not impact personal lending. However, as discussed above, inflation contributes to higher household expenses and will affect affordability calculations. The significant impact of the CCCFA is demonstrated by the level of decline despite the relatively low influence of other credit market changes over personal lending.

257. Declines in new credit card and personal loan levels are consistent with the expected impacts of the CCCFA changes, given these products were subject to a higher level of concern before the reforms. Therefore, personal lending was expected to be subject to increased restrictions and subsequent declines in new loan levels, in line with the policy intent.

Chapter Five: Intended and unintended impacts of the CCCFA changes

258. The following chapter contains our assessment of the intended and unintended impacts of the CCCFA changes.

    a. expected impacts consistent with the policy intent

    b. the extent to which intended impacts are being achieved

    c. the unintended impacts identified.

5.1 Expected impacts

259. As set out in Chapter Two, the CCCFA changes were made to address 'continued irresponsible lending and other non-compliance'.

260. For borrowers, the CCCFA changes were expected to:

    a. tighten access to credit, especially where this was previously being granted in unaffordable or unsuitable circumstances – it was acknowledged that this may mean that some consumers could lose access to credit, especially where alternative avenues for finance, such as family and friends, were not available

    b. reduce financial hardship by providing consumers with better protection from high-cost loans and unaffordable debt

    c. increase the cost of credit, where the costs of implementation and compliance were passed on to consumers.

5.2 Extent to which intended impacts are being achieved

261. Throughout the investigation, financial mentors and other consumer advocates consistently told MBIE that most of the benefits sought by the CCCFA changes would take 6–12 months to be visible. This was on the basis that most debts encountered by financial mentors have been incurred some time prior, and in some cases clients have been struggling with accumulated debts for a considerable period before they see a financial mentor.

262. For this reason, we consider that it is too early to say whether or not the CCCFA changes are likely to be successful in achieving their main desired impacts and objectives. MBIE has collected a baseline of evidence (including survey evidence and data from financial mentoring services) that is expected to provide a stronger basis for drawing conclusions about the extent of the expected outcomes of the CCCFA changes are realised 2–3 years from implementation.

263. Financial mentors have reported that the CCCFA changes – particularly record keeping requirements – have increased their ability to identify irresponsible lending and to make complaints to dispute resolution schemes. This is consistent with the outcomes being sought.

264. In addition, we understand that previous changes made by the Credit Contracts Legislation Amendment Act 2019 had an almost immediate effect on high-cost lending, such that only one participant remains in that market.

265. The investigation largely interviewed lenders who were known, prior to 1 December, to have relatively robust affordability processes – these lenders were best placed to report on unintended impacts.

5.3 Unintended impacts of the CCCFA changes

266. The investigation has highlighted some unintended impacts of the CCCFA changes to affordability requirements and liability:

   a. more borrowers across all lending types who should pass the affordability test are subject to declines or reductions in credit amount.

   b. borrowers are subject to unnecessary or disproportionate inquiries that are perceived by them as intrusive.

267. These unintended impacts are the result of the following:

   a. Lending processes, in practice, have become more restrictive and onerous than was expected when the CCCFA changes were made. This is a consequence of the way a number of specific provisions in the regulations are designed and drafted, combined with interpretational difficulties and many lenders taking a naturally conservative approach to compliance given the CCCFA's strong liability regime.

   b. the prescriptive nature of the CCCFA changes and their application to almost all consumer lending also mean that lending has been impacted outside of areas where there is a high risk of irresponsible lending and consumer harm.

268. In addition to the above features of the CCCFA changes and their implementation, the CCCFA changes have also been an apparent trigger for some lenders to make wider changes to their credit assessment processes to allow for the automated collection of more extensive information about customers' finances, with a range of potential applications (including CCCFA compliance). These new systems have sometimes fallen short of their promise and are likely to have also contributed to some adverse consumer experiences.

5.3.1 Evidence of the unintended impacts

5.3.1.1 Evidence for borrowers being declined affordable credit

269. Lending data shared in Chapter Four demonstrates that the number of new borrowers for mortgages and other consumer finance has been dropping since December 2021. While this decline in new borrowers seems to largely be driven by reduced number applications, data shared by credit reporting agencies also indicates that conversion rates have fallen for borrowers across all lending products, indicating that more applications are being withdrawn or declined. This is consistent with data supplied by individual lenders.

270. This evidence is strengthened by both:

    a. case studies provided by lenders showing how processes implemented in response to the CCCFA changes have led to affordable credit being declined – either through greatly increased expense estimates, large surplus requirements, or a lack of discretion to consider wider factors

    b. information we have gathered about features of the Regulations, and the way they have been interpreted and applied, that we would expect to have driven increases in declined and withdrawn applications, i.e. providing a plausible mechanism. These underlying causes are set out in section 5.3.2.

5.3.1.2 Evidence for unnecessary or disproportionate inquiries

271. The Banking Ombudsman shared there has been an increase in lending complaints between October and December last year compared with the previous quarter. The complaints related to delays, banks not acting as expected, and having to provide more information.

272. Consistent with recent media attention, lenders claim that borrowers are complaining the new, more in-depth inquiries being conducted as part of the affordability assessment are intrusive in nature. This was a common theme amongst lenders, suggesting the problem is widely prevalent.

5.3.2 Underlying drivers of the unintended impacts

5.3.2.1 Underlying driver 1: lack of targeting

273. A more fundamental driver of the unintended impacts is that the Regulations apply to almost all consumer lending with limited exceptions, rather than just the lending intended to be targeted by the CCCFA changes. It is most directly resulting in unnecessary or disproportionate inquiries to low-risk borrowers (who arguably should not require a full affordability assessment to establish loan affordability) and has some implications for borrowers being unnecessarily declined.

274. The impact of this driver is strongly connected to uncertainty around use of the exception for 'obvious' affordability, which is the main exception to a full affordability assessment for low-risk borrowers. Where borrowers fall outside this exception, or it is not otherwise used, the prescriptive nature of the regulations means borrowers are subject to the same extent of

inquiries as higher risk borrowers. Low risk borrowers are more likely to find this intrusive, as they are unlikely to have been subject to the same level of inquiries prior to the CCCFA changes.

5.3.2.2 Underlying driver 2: design and drafting of specific provisions in the Regulations

275. A number of specific provisions of the Regulations added from 1 December may be contributing to the unintended impacts:

   a. Regulation 4AF(2)(a) requires lenders to estimate likely relevant expenses, which goes beyond the minimum needs of the borrower to include expenses that the borrower intends to make or continue after entering into the contract.

   b. Similarly, the definition of 'listed outgoings' (regulation 4AE) includes regular outgoings that the borrower is 'unable or unwilling to cease', which creates situations in which there is a mismatch between what borrowers say they intend to continue paying (on the basis of their own beliefs about affordability) compared to what they would actually continue with if at serious risk of substantial hardship.

   c. Regulation 4AF(2) sets a formula for most affordability assessments. 4AF(2)(b) requires likely income must be greater than likely expenses, in addition to 4AF(2)(b)(i) and (ii) which require appropriate surpluses or buffers/adjustments are applied to account for uncertainty) which takes away the ability for lenders to approve lending based on other factors that might suggest affordability.

   d. Regulation 4AL(2) sets out a prescriptive and conservative approach for lenders to estimate the expenses that may arise from revolving credit contracts, which does not take into account borrowers who use these facilities for day-to-day transactions and pay them off each month, rather than making large purchases to be paid back over months or years.

5.3.2.2.1 Regulation 4AF(2)(a) and 'likely expenses'

276. The policy intent behind 4AF(2)(a) was that lenders would go beyond capturing basic expenses related to the minimum needs of the borrower to capture those expenses which were likely to be relevant to risk of substantial hardship. Thus, under 4AF(2)(a), lenders are required to estimate *likely* income and relevant expenses. This reflects previous Code guidance (paragraph 5.12 of the June 2017 version of the Code), as well as a view that:

   a. The affordability test should be forward-looking: what matters is what the borrower's income and expenses will be after the loan is entered into, not their historic income and expenses.

   b. Borrowers each have unique circumstances and preferences that mean their minimum level of expenditure to avoid substantial hardship will vary. In some cases, they may have ongoing expenses that are not objective 'needs', but which are essential to them and may be prioritised above other apparent needs.

   c. Where the cost of repayments from a new loan would result in borrower's expenses exceeding their income, borrowers may plan to cut back on non-essential expenditure

and are able to indicate this to the lender. Lender estimates of likely expenses should therefore be equal to the borrower's actual required expenditure.

277. In practice, however, there may be a mismatch between expenditure that a borrower considers affordable and intends to continue, and expenditure that the lenders' calculations indicate would be affordable. For instance, a borrower may consider that a television subscription will continue to be affordable after they have taken out the loan, and may tell a lender that they are intending to keep paying for it; therefore, this would form part of the borrower's likely expenses. However, other assumptions the lender makes about the borrower's expenses (such as the potential cost of repayments under a revolving credit facility) could result in this expenditure appearing unaffordable in the lender's calculations.

278. If the borrower later discovered that their planned expenditure was unaffordable, they might well cut it back to avoid hardship. However, because the regulations effectively derive likely expenditure from the intentions of the borrower at the time of the loan, lenders are generally not able to take account of any cutbacks of discretionary expenditure that go beyond what the borrower has said they are intending to make.

279. Case studies shared by lenders support this conclusion; borrowers with high discretionary income have increased discretion to reduce expenses but are less likely to think it necessary to reduce expenses when applying for the credit contract, particularly when applying for small increases or amounts of consumer finance. However, whether such borrowers would forego said expenses when facing financial difficulty is another consideration entirely.

280. This can result in genuinely affordable lending appearing unaffordable under the Regulations.

5.3.2.2.2 The definition of 'listed outgoings' in regulation 4AE(d)

281. 'Relevant expenses' are defined as 'listed outgoings' over the next 12 months that the borrower will meet out of income. 'Listed outgoings' are in turn defined as:

> *(a) fixed financial commitments, including accommodation costs, insurance, rates, body corporate fees, school fees, and child support that is payable under the Child Support Act 1991:*
>
> *(b) payments of any debts (whether existing debts or payments under the agreement being entered into or materially changed):*
>
> *(c) living expenses, including utilities, food and groceries, personal expenses (including clothing and personal care), other costs associated with dependants if applicable (such as child care), medical expenses, and transport expenses:*
>
> *(d) any regular or frequently recurring outgoings (for example, savings, investments, gym memberships, entertainment costs, or tithing) that are material to the estimate of relevant expenses and that the borrower is unable or unwilling to cease after the agreement is entered into or materially changed*

282. Paragraph (d) of listed outgoings reflects the concept of 'likely' expenses and requires lenders to capture certain regular or frequently recurring expenses 'the borrower is unable or unwilling to cease'. Lenders see this language, alongside the requirement at 4AK(2)(b) to

obtain information in sufficient detail, as a signal they need to make more detailed inquiries with customers about regular and frequently recurring expenses than prior to the changes.

283. Examples of extra expenses that are being caught following the changes include savings, investments, optional loan repayment increases, donations, tithing, community contributions and entertainment expenses. Typically, these categories of expenses represent discretionary spending that borrowers are unlikely to cease before it is necessary to do so.

284. Many of these expenses are not 'benchmarkable' (as there is no 'average' level of the expense that the expenses should be compared to) and therefore lenders are generally required under regulation 4AM to verify the expenses against documentary evidence such as bank statements.

285. Alternatively, if lenders are using bank transaction records as the main source of their initial estimates of expenses (under regulation 4AK(2)(a)(ii)), this may involve a detailed search for expenses that appear to be 'regular or frequently recurring' followed by queries with the borrower as to whether they are 'unable or unwilling to cease' the expenses.

286. This results in:

    a. As with the issue of 'likely' expenses, a borrower's intention to continue expenditure (on the basis of their own perception of its affordability) means lenders may not be able to exclude discretionary expenses to reflect what the borrower would be willing to forego in financial hardship. Capturing all the expenses declared by the customer tends to overestimate expenses which affect borrowers' ability to meet the threshold that likely income exceeds likely expenses. This contributes an artificial picture of the borrower's affordability and can lead to borrowers being declined affordable credit.

    b. Inquiries into whether the borrower is 'unable or unwilling to cease' various discretionary expenses are perceived as intrusive by many borrowers, particularly if a borrower considers the expense to be affordable and expects to continue paying it.

287. The initial changes announced on 11 March 2022 partially addressed the over-capture of discretionary expenses under the definition of 'listed outgoings' by removing 'savings' and 'investments', and by clarifying aspects of how the affordability assessment is carried out. Further potential changes are discussed in Chapter Six.

5.3.2.2.3 Regulation 4AF(2)(b) and the affordability assessment 'formula'

288. Regulation 4AF(2)(b) limits the circumstances in which a lender can be satisfied that it is likely that a borrower will make loan payments without substantial hardship to where likely income exceeds likely expenses. A reasonable surplus is also required unless the lender has incorporated sufficient buffers and adjustments into income and expenses to account for uncertainty in its estimates.

289. The affordability assessment 'formula' in this regulation applies to most consumer credit contracts unless an exception applies.

290. Lenders would previously grant loans to borrowers whose likely expenses exceeded their likely income, on the basis of case-specific judgement about what is affordable. Mitigating factors taken into account included the lender's view of the product's risk, the borrower's repayment

history, and the availability of assets that the borrower might be able to use to repay the loan if they faced substantial hardship. This discretion is clearly not permitted following the changes.

291. Whether this is genuinely a shortcoming of the Regulations depends on whether it is accepted that the affordability test in section 9C(3)(a)(ii) of the Act is genuinely met in these circumstances, and whether allowing discretion by lenders is viewed as desirable or an invitation to irresponsible lending. The notion that the borrower's income needs to exceed the expenses that the borrower intends to pay from that income (including repayment of the loan) appears on its face to be a logical necessity of the Act's requirement that the borrower is likely to make payments without substantial hardship. However, given the intentionally prescriptive nature of the Regulations and the assumptions built into it, there will always be circumstances where estimated income and expenses differ from reality. A careful, well-motivated lender can be expected to identify situations where lending is affordable, contrary to the application of a prescriptive formula.

292. Where the test in the Act is met but the test in the Regulations is not, there are likely to be unwarranted declines.

5.3.2.2.4 Regulation 4AL(2) and the treatment of revolving credit contracts

293. Regulation 4AL introduced prescriptive requirements about how to calculate the ongoing expenses associated with borrowers' revolving credit contracts. It was intended that lenders would be required to assume an expense from BNPL facilities on the basis of the borrower fully utilising their facility and repaying it over time.

294. For credit cards, this treatment does not take into account borrowers who use these facilities for day-to-day transactions and pay them off each month, rather than making large purchases to be paid back over months or years. When borrowers use credit cards for living expenses or other regular expenses, the expense is arguably double counted as both repayments on the facility and the underlying expense.

295. The application of 4AL to BNPL raises similar issues, which are exacerbated by the fact that individual transactions made on BNPL facilities need to be repaid in full over a short period (less than 3 months). Lenders using the full BNPL credit limit with a short period to calculate repayments result in a high assumed expense.

296. This treatment of revolving credit contracts drives higher expense estimates which may reduce the borrowers' surplus below the required level and result in a decline of affordable credit.

297. In each case there are some potential counterarguments. The fact that a borrower may have used a revolving credit contract for living expenses or that the borrower previously used a revolving credit contract for small payments does not mean that it will notBN be used in other ways in the future. For example, a borrower might well go on to use their facility to make a larger one-off purchase, leaving them with both their existing living expenses and a new liability that they must repay. Revolving credit contracts tend to be inherently flexible sources of credit that provide for borrowers to incur substantial financial obligations.

298. Further potential changes are set out in Chapter Six.

5.3.2.3 Underlying driver 3: interpretational issues

299. As well as the design and drafting of specific provisions in the regulations, it has become apparent that the interpretation and implementation of the Regulations has sometimes been more onerous and restrictive than the original policy intent. As set out in Chapter Six, many of these issues were considered as part of the initial round of changes agreed by Cabinet. In particular:

    a. In implementing regulation 4AK(2), some lenders appear to be estimating living expenses by asking the borrower to declare them, reconciling them from bank transactions records and comparing them against a benchmark. The policy intention was that, where a borrower declared living expenses, they could either be verified against bank transaction records or compared against a benchmark (where both of these were options).

    b. Some lenders, in accordance with regulation 4AK(2), use recent bank transaction records to estimate likely expenses (with or without also asking the borrower to declare expenses), but are concerned that they are not able to adjust those expenses down appropriately (e.g., by asking the borrower whether they will forgo discretionary expenses and discretionary components of expenses) to reflect that borrowers are likely to cut back expenses.

    c. Some lenders have set surplus income requirements (under Regulation 4AF(2)(b)(i)) in a way that does not appear to be 'discounted' for other adjustments and buffers used in income and expense estimates.

    d. Although some lenders are using the 'obvious' exception in certain cases, lenders have generally found it difficult to make systematic use of the exception based on current guidance.

5.3.2.3.1 Regulation 4AK(2) and unnecessary use of bank transaction records

300. Some lenders appear to be estimating living expenses by asking the borrower to declare them, reconciling them from bank transactions records and comparing them against a benchmark. The policy intention was that, where a borrower declared living expenses, they could either be verified against bank transaction records or compared against a benchmark (where both of these were options). The intended approach aligned more closely with the pre- 1 December processes of many banks, which were typically to take the higher of declared and benchmarked living expenses, without detailed investigation into bank transaction records of living expenses.

301. However, many lenders are choosing to create initial estimates of some types of expenses using bank transaction records. This often results in the inclusion of discretionary components that overestimates likely expenses. This contributes to higher expense estimates where lenders to do not subsequently adjust the estimate to account for discretionary components.

302. Some lenders may also subsequently compare bank transaction records to benchmarks and use the higher of the two in the initial expense estimate. This is unnecessary, as bank transactions give a complete picture of the borrowers actual expenses. Given that bank

transactions tend to overestimate expenses, subsequently applying an even higher benchmark gives a false view of the customers expenses and affordability.

303. Furthermore, where lenders use bank statements to capture expenses, they are capturing expenses at the granular level. They also often need to clarify regular or frequently recurring discretionary components with the borrower. This is partially driven by the requirement to obtain information in sufficient detail.

304. The granular level of detail expenses are captured in drives more detailed questioning about a wider range of discretionary expenses. This, in combination with the sometimes personal nature of discretionary expenses, subsequently drives the perception that lenders are behaving intrusively.

305. This issue was partially addressed by the initial changes agreed to by Cabinet, which clarify that when lenders ask borrowers about their likely living expenses and these are benchmarked against statistical data about household expenses, there is no need to inquire into their current living expenses from recent bank transactions.

306. These initial changes and potential further changes are set out in Chapter Six.

5.3.2.3.2 Regulation 4AK(2) and adjusting expenses for expected cutbacks

307. As discussed above, many lenders use recent bank transaction records to estimate likely expenses, with or without also asking the borrower to declare expenses. The overestimation of expenses that can occur when using bank statements to estimate expenses (as discussed above) becomes problematic where lenders do not subsequently adjust the estimate.

308. Lenders are concerned that there is insufficient guidance enabling them to adjust expenses down appropriately (e.g., by asking the borrower whether they will forgo discretionary expenses and discretionary components of expenses) to reflect that borrowers are likely to cut back expenses. The policy intent was that further inquiries could occur and be taken into account by lenders in order to generate estimates that reflected likely cut-backs.

309. There is currently limited guidance on this practice in the Code. Thus, in practice, lenders are making artificially high expense estimates that do not reflect the intent to capture expenses which are relevant or material to the estimate. Higher expense estimates drive declines where lending is affordable in reality.

310. The initial changes proposed to address this issue by clarifying that if lenders have estimated living expenses from bank transaction records, 'asking borrower about their relevant expenses' includes obtaining information about how relevant expenses are likely to change once the contract is entered into.

311. These initial changes and potential further changes are set out in Chapter Six.

5.3.2.3.3 Regulation 4AF(2)(b) and the substitution of adjustments and buffers for a reasonable surplus

312. Some lenders have set surplus income requirements (under Regulation 4AF(2)(b)(i)) in a way that does not appear to be 'discounted' for other adjustments and buffers used in income and

expense estimates. The policy intent was that surplus income requirements and buffers/adjustments applied to income and expenses were alternatives.

313. However, 'reasonable surplus' is not clearly defined. This means lenders have tended to be more conservative in calculation of a reasonable surplus value than they may otherwise need to be.

314. In practice, lenders are strictly applying a baseline reasonable surplus requirement to all lending products as well as buffers and adjustments. Lenders have not indicated that this reasonable surplus requirement will be reduced or removed where the lender has already applied buffers to variable income and expenses, nor where there is a lower level of risk.

315. This response produces an artificial picture of affordability. The application of buffers increases borrowers' expenses above the actual level to account for variability. The higher expense estimate and lower income estimate generated by the application of buffers subsequently reduces the borrowers' net surplus. This means borrowers are less likely to meet the necessary threshold and are more likely to be declined where lending is affordable.

316. The initial changes proposed to make changes to the guidance in Chapter 5 of the Code. These options included that reasonable surplus can be reduced to the extent they include adjustments and buffers beyond those implied the regulations. For home loans, it has been suggested that lenders may choose not to use reasonable surplus requirements if they make specific adjustments to their assessment. These changes are explained in more detail in Chapter Six.

5.3.2.3.4 Regulation 4AG and use of exception for 'obvious affordability'

317. Although some lenders are using the 'obvious' exception in certain cases, lenders have generally found it difficult to make systematic use of the exception based on current guidance.

318. The current guidance in the Code sets out that 4AG applies where the lender makes inquiries that are sufficient to establish that it is obvious in the circumstances of the particular case that the borrower will make the payments under the agreement without suffering substantial hardship, so as to make the inquiries required by regulation 4AF disproportionate. Lenders claim this guidance is not thorough enough to apply the exception to borrowers who meet any threshold lower than the example given in the Code.

319. This means lenders are undertaking full affordability assessments for borrowers who demonstrate very strong affordability. Borrowers who were envisioned to meet the 'obvious' affordability threshold are less likely to have been assessed in the same level of depth as other borrowers previously, which is likely to drive a stronger perception that the inquiry is intrusive.

320. While Cabinet has not agreed to changes in the guidance around the exception for obvious affordability, it has not yet agreed to any substantive changes to the regulation itself. Further potential further changes are set out in Chapter Six.

5.3.2.4 Underlying cause 4: conservative lender approach given CCCFA liability regime

321. While the above interpretational issues reflect gaps in guidance and expected differences between potential interpretations, a key driver of more conservative interpretations of the

CCCFA is its relatively strong liability and penalties regime, and particularly its imposition of duties on directors and senior managers.

322. The regulations typically provide multiple pathways for lenders to comply and, whilst overall prescriptive, include many provisions that involve judgements about what is 'reasonable' in the circumstances. Regulations 4AE through to 4AO (the substantive regulations covering affordability) include the words 'reasonable' or 'reasonably' 20 times. Lenders are also invited to consider what income and expenses are 'likely', and to 'take account' of various information to inform their assessment of affordability. All these terms, and many more, require use of judgement in the design of processes to ensure that compliance is achieved.

323. Where there are multiple interpretations of a given regulation, the liability regime means that lenders have tended to take the interpretation that yields a more conservative and easily defendable result. A more conservative approach typically results in lower income estimates, higher expense estimates, more extensive surpluses, buffers and adjustments and therefore a greater likelihood that lending will be declined. It also results in more detailed inquiries that may be strictly necessary, and an aforementioned reluctance to make use of more subjective exceptions to a full affordability assessment, such as 4AG's test of 'obvious' affordability.

5.3.3 Wider process changes triggered by the CCCFA changes

324. In addition to the above features of the CCCFA changes and their implementation, the CCCFA changes have also been an apparent trigger for some lenders to substantially reorganise their credit assessment processes to allow for the automated collection of more extensive information about customers' finances, with a range of potential applications (including CCCFA compliance). These new systems have sometimes fallen short of their promise and are likely to have also contributed to some adverse consumer experiences.

325. Lenders have increasingly adopted processes that make use of bank transaction records and other data sources to estimate borrower income, expenses and liabilities, and have applications beyond CCCFA compliance, such as automated loan assessments and repurposing consumer data for new products, or product and process improvements. These investments and process changes may not have been strictly necessary for CCCFA compliance, but they do mean that some of the process changes that have triggered by the CCCFA changes are likely to be irreversible.

326. Although these technologies show much promise, some lenders have told us that their implementation has fallen short of their potential to date. For example, some systems that automatically categorise bank transaction data to estimate borrower expenses have, in practice, required a great deal of manual input and further inquiries to borrowers to identify unclassified or misclassified transactions. Despite much progress being made in the field of machine learning over the past 20 years, computers remain limited in their ability to take highly context-specific real-world factors into account in decision-making. Given the drive to automate lending processes, particularly for small loans and credit facilities, this has implications for the use of judgement and discretion in decision-making in future.

Chapter Six: Initial and potential further changes

327. This chapter sets out the:

    a. initial changes already being progressed following Cabinet agreement in February 2022

    b. potential further changes that could be explored, and their likely impact on enabling consumers to access credit responsibly, and

    c. areas that would require further investigation.

328. Further work would be needed to identify preferred options from those that could be explored. Therefore, this report does not make policy recommendations.

6.1 Initial changes

329. On 11 March 2022 the Minister of Commerce and Consumer Affairs announced a number of 'no regrets' changes to the Regulations and Code, in line with the existing policy intent of the Act and Regulations, and in advance of the investigation's conclusion. This was intended to allow the Government to respond more expeditiously to the concerns raised by consumers and lenders, ahead of the investigation reporting back.

330. From 4 April to 20 April MBIE held a public consultation on the exposure draft regulations and draft Code changes. MBIE is now in the process of considering and implementing feedback provided in the submissions. We received 23 submissions from lenders, industry groups, consumer dispute resolution schemes and consumer advocates. Overall, these submissions were supportive of the policy changes. Most lenders reiterated their concern that further changes were needed to improve ease of access to safe credit. The Minister of Commerce and Consumer Affairs intends to issue the revised version of the Code in June, and for the amended regulations and revised Code to come into force in July.

331. The six changes announced by the Government to the Regulations and/or the Code are set out below.

TABLE 3: CABINET AGREED CHANGES TO THE REGULATIONS AND/OR RESPONSIBLE LENDING CODE

- Amending the Regulations to exclude savings and investments from the definition of the 'listed outgoings'
- Clarifying that when lenders ask borrowers about their likely living expenses, and these are benchmarked against statistical data about household expenses, there is no need to inquire into their current living expenses from recent bank transactions
- Clarifying that when lenders estimate expenses from recent bank transaction records, lenders can ask the borrower about how expenses are likely to change once the contract is entered into
- Clarifying the requirement to obtain information in sufficient detail to minimise underestimation only relates to information received from borrowers (e.g. ensuring that expense categories on application forms are sufficiently detailed) rather than relating to information from bank transaction records etc
- Amending the Code to further clarify when a 'reasonable surplus' is required and how it should be set
- Amending the Code to remove the current example for when affordability is 'obvious' and consider alternative guidance and examples.

332. The initial changes to the Regulations and the Code are largely directed at addressing one of the key underlying drivers identified in Chapter Five – interpretational issues. By providing greater clarity around the interpretation of the Regulations and allowing more reliance on borrower declarations and statistical benchmarking, these changes are intended to address over-estimation of expenses. This is likely to lead to higher credit approval rates and increased access to safe credit. Furthermore, changes to remove 'savings' and 'investments' from expense estimates, clarifications around use of bank transactions and the exception for obvious affordability are intended to reduce the extent to which borrowers are subject to intrusive inquiries.

333. However, the initial changes by themselves would not address the other drivers of unintended impacts identified in Chapter Five.

6.2 Potential further changes

334. Potential further changes that would address the unintended impacts of the CCCFA changes are summarised in Table 4 and discussed below.

Table 4 Summary of potential further changes

DESCRIPTION OF FURTHER CHANGE
AMEND THE AFFORDABILITY REGULATIONS TO BETTER TARGET SPECIFIC KINDS OF LENDING, LENDERS, OR CERTAIN CONSUMERS WHERE THERE IS A HIGHER UNDERLYING RISK OF SUBSTANTIAL HARDSHIP
Targeting the scope of the affordability regulations to specific consumer credit contracts – e.g. personal lending and motor vehicle lending, lending under a certain dollar amount, lending over a certain period of time, unsecured lending, or lending above a specific interest rate
Targeting the scope of the affordability regulations to borrowers with certain characteristics – e.g. a credit score below a certain level, higher debt to income ratios, record of personal insolvency, or borrowers who are new to the lender
Targeting the scope of the affordability regulations to certain types of lenders – e.g. excluding lenders who are regulated by RBNZ, or excluding lenders who have received some form of accreditation for their compliance systems and few upheld complaints
CHANGES TO LIKELY RELEVANT EXPENSES AND LISTED OUTGOINGS
Modifying 'likely relevant expenses' to exclude expenses that a responsible lender would expect the borrower to forgo to avoid substantial hardship
Narrowing paragraph (d) of the definition of 'listed outgoings' (other regular outgoings) to excluding outgoings that a responsible lender would expect the borrower to forgo to avoid substantial hardship
Removing paragraph (d) of the definition of 'listed outgoings'
CHANGES TO ASSUMPTIONS ABOUT DEBT REPAYMENTS FROM REVOLVING CREDIT CONTRACTS
Providing that lenders may exclude buy now pay later schemes from relevant expenses.
Providing that lenders may exclude existing credit cards from relevant expenses if the borrower routinely repays the card balance without incurring interest.
CHANGES TO EXCEPTIONS FOR REFINANCING, OR EMERGENCY CREDIT
Expand the exception for variations and replacement of existing contracts to include credit contracts from other lenders, where total repayments are lower in the new arrangement.
Provide a new exception for 'emergency credit'
CHANGES TO REQUIREMENTS TO SATISFY THAT IT IS LIKELY THE BORROWER WILL MAKE REPAYMENTS WITHOUT SUFFERING SUBSTANTIAL HARDSHIP
Amend the regulations to limit the requirement that likely income exceeds likely expenses (plus a reasonable surplus, buffers or adjustments where applicable) to target areas (as per the options on narrowing the scope of the regulations above)
Amend the regulations to remove the requirement that likely income exceeds likely expenses (plus a reasonable surplus, buffers or adjustments where applicable) to allow more lender discretion
REPEAL REGULATIONS
Repeal the affordability regulations and return to the principles-based model used pre-1 December.
CHANGES TO PENALTIES AND LIABILITY REGIME
Reduce the onerousness of due diligence duties of directors and senior managers under section 59B of the Act
Reduce the penalties and liability settings for breaches of the Act under sections 107A – 107E and 88 – 92, e.g. reduction in penalties amount and or allowing directors to indemnify themselves against liability.

335. We note that further regulatory design, consultation and impact analysis will be required should the Government pursue any of these further changes.

6.2.1 Changes to the affordability regulations

336. A range of changes could be made to the Regulations to address the key underlying divers identified in Chapter Five. Some of these changes would be broadly consistent with the intent of the CCCFA changes (such as amending the Regulations to target certain types of contracts, borrowers or lenders) while others would represent a policy change away from the CCCFA changes (such as repealing the Regulations).

6.2.1.1 Changes to target the scope of the Regulations

337. Further work could be conducted on developing options for amending the affordability regulations to target specific characteristics of lending products, lenders or borrowers.

338. Targeting the affordability regulations would be consistent with the original policy intent and could address a key underlying driver of the unintended impacts identified in Chapter Five, which is that the Regulations are applied to almost all consumer lending with limited exceptions, rather than targeting high-risk consumer lending.

339. The amendments could then be designed as setting out when a full affordability assessment is required (effectively narrowing the scope of the regulation) or when it is not required (effectively broadening the exceptions).

340. In general, targeting is likely to result greater discretion for lenders as only certain consumers and/or credit contract products would be required to undergo a full affordability assessment.

341. Where lenders are not required to conduct full affordability assessments, they would have discretion in how they conduct affordability assessments, in accordance with the principle-based requirement in section 9C(3)(a)(ii) of the Act.

342. Insofar as the design of the amendments target high-risk consumer lending, there is the possibility of increasing consumer access to safe credit whilst still maintaining a relatively strong level of consumer protection.

343. As set out further below, there are a number of potential approaches for targeting lending products, lenders or borrowers.

344. Some approaches to targeting specific products or types of lenders were considered in the development of the Regulations but were at the time considered as undesirable or unworkable by stakeholders, or lacked consensus, and were ultimately not pursued.

345. Potential approaches to further target the scope of the affordability regulations are all imperfect proxies for targeting high-risk consumer lending. To mitigate this, in developing options, consideration could be given to combining different approaches to mitigate the limitations of specific approaches.

346. Where the affordability regulations do not apply, there is a risk that consumer protection for some borrowers is lessened due to greater uncertainty about what is required by the lender responsibilities principles set out in the Act, and difficulties for regulators and consumers enforcing breaches of the principles. Some guidance on meeting the principles-based requirement could be reintroduced into the Responsible Lending Code. The record-keeping requirements in the Act, which require lenders to record their affordability assessments and for those records to substantiate the affordability of the loan, also introduced as part of the CCCFA changes, would also provide a further mitigation in relation to difficulties for regulators and consumers enforcing breaches of the obligations.

6.2.1.1.1 Possible approaches to targeting specific products

347. A possible approach to targeting specific products could be to target certain kinds of consumer credit contracts, for example for products:

    a. above a certain interest rate, e.g. above a standard bank credit card rate of around 20-23%

    b. specific types of lending, e.g. motor vehicle lending, or unsecured personal loans

    c. lending under or over a certain dollar amount, e.g. $2,000

    d. lending over a certain period of time, e.g. under 12 months.

348. This approach has some analogue to the current regime for high-cost consumer credit contracts (interest rate over 50%). We understand that following implementation of interest and fee caps (from 1 May 2020 and 1 June 2020) as part of the Credit Contracts Legislation Amendment Act 2019, there is only one such lender remaining in the New Zealand market.

349. It would also have some analogue to the Australian consumer credit regime which imposes additional lending obligations on small amount credit contracts (SACCs) and certain consumer leases. Australian credit law defines these contracts on the basis of characteristics such as whether the credit is continuing, the limit of the credit contract (up to $2,000), the term of the contract, whether or not it is secured, in addition to other features. The rationale for additional responsible lending obligations for SACCs is that credit contracts with these characteristics have been identified as higher risk than others.

350. Taking this approach could improve access to products that were excluded from the affordability regulations, however, does have some drawbacks if applied on its own. There are likely to be circumstances where the same product poses a high risk to some borrowers but a low risk to others. For example, it could be argued that small credit contracts are low-risk for many borrowers, but for some borrowers could be a sign that they are struggling with relatively small expenses.

6.2.1.1.2 Possible approaches to targeting borrower characteristics

351. Another possible approach is to target consumer credit contracts where the borrower has certain characteristics, for example if a borrower:

    a. has a credit score below a certain level

    b. has a high debt to income ratio

    c. has a record of personal insolvency

    d. is new to the lender.

352. There are some risks in using these characteristics as a proxy for low risk of affordability issues. Credit scores and repayment history will not, in themselves, be decisive as to whether affordability is obvious. The fact that loans have been repaid does not always mean that they

were affordable without substantial hardship, and also does not mean that any future loan will be affordable without substantial hardship.

353. These risks could be mitigated by combining the targeting to borrower characteristics with targeting of the type of lending product so that the full affordability assessments are required for certain types of lending products irrespective of the character of a borrower, for example where the credit contract is over a certain interest rate.

6.2.1.1.3 Possible approaches to targeting certain kinds of lenders

354. Another possible approach could be to target or exclude specific lenders or classes of lenders, for example excluding lenders who:

    a. have few or no documented instances of irresponsible lending in the past, e.g. through disputes that have been upheld by a disputes resolution service relating to responsible lending

    b. are regulated by the Reserve Bank – registered banks and non-bank deposit taker

    c. have been accredited by a third party as having strong compliance systems for responsible lending.

355. This approach would attempt to exclude lenders who were trusted to exercise discretion in accordance with the lender responsibility principles from compliance with more prescriptive regulations, and target those who were not. It would be consistent with notions that particular lenders or classes of lenders are responsible and other lenders are identifiable as irresponsible.

356. However, some variations of this approach could provide a competitive advantage to incumbent lenders and business models (e.g. an exclusion for registered banks), raise barriers to entry (through third party accreditation) or otherwise harm competition.

6.2.1.2 Specific changes to what and how expenses are estimated

357. Further work could be conducted on potential changes relating to what and how likely relevant expenses are estimated. The potential further changes set out below would be consistent with the intent of the CCCFA changes and would address the key drivers for the unintended impacts relating to the design and drafting of specific provisions in the Regulations and interpretational issues.

358. Overall, these set of potential further changes are not mutually exclusive and would complement the changes to the to target the scope of the affordability regulations by ensuring that where an affordability assessment is required, the design and drafting of specific provisions does not unduly impact and disadvantage those borrowers.

359. Some of the proposed specific changes to what and how expenses are estimated which remove, or narrow the scope, of the requirement would have a similar effect to the changes to target the scope of the affordability assessment as they would reduce the application of these particular requirements.

6.2.1.2.1 Changes to 'likely' relevant expenses and 'listed outgoings.

360. As discussed in Chapter Five, the requirement to estimate 'likely' relevant expenses in regulation 4AF(2)(a) and the definition of 'listed outgoings' under regulation 4AE is resulting in lenders capturing discretionary components of expenses that would have not been captured prior to the changes. This is contributing to an increase in a borrower's expense estimate.

361. The definition of 'listed outgoings' in regulation 4AE is driving inquiries that are disproportionate or unreasonable. In particular, paragraph (d) describes expenses the borrower is unable or unwilling to cease which lenders have interpreted as being a requirement that they need to make further inquiries with borrowers about these expenses.

362. We expect that the initial changes relating to listed outgoings and estimate of likely relevant expenses[9] will partly address interpretational issues. Further changes would improve the design and drafting of the Regulations and assist with addressing the unintended impacts identified.

363. Possible approaches could include:

    a. modifying 'likely relevant expenses' to exclude expenses that a responsible lender would expect the borrower to forgo to avoid substantial hardship

    b. narrowing paragraph (d) of the definition of 'listed outgoings' (other regular outgoings) to excluding outgoings that a responsible lender would expect the borrower to forgo to avoid substantial hardship, or

    c. removing paragraph (d) of the definition of 'listed outgoings'.

364. In general, these approaches could all result in improving ease of access to credit by providing greater discretion to lenders to make responsible judgments on the expenses beyond those required in the remainder of regulation 4AE. They would address the unintended over-estimation of expenses and unreasonable or unnecessary inquiries that has resulted from the application of paragraph (d).

365. The first two approaches involve introducing a more objective test into the regulations, around what a responsible or reasonable lender would expect the borrower to cease, rather than asking the borrower (explicitly or through declarations of likely expenses) what they intend to cease.

366. However, excluding expenses that lenders expect the borrower to forgo does create some risk that lenders misclassify non-discretionary expenses as discretionary. Whether borrowers will cease various expenses to avoid substantial hardship will often depend on their circumstances, including social expectations. This risk could be mitigated as lenders would be expected under section 9CA to demonstrate that their assumptions about the borrower's expenses are

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[9] Cabinet has agreed with the recommendation to amend the Regulations and Code to remove 'savings' and 'investments' from paragraph (d) of the definition of 'listed outgoings' and amending regulation 4AK(2)(b) ('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 to an extent that is material to the estimate') to limit information sought from the borrower under regulation 4AK(2)(a)(i), i.e. not information under (2)(b)(ii) or (iii).

reasonable. These changes could be supported by providing additional guidance in the Code around what kinds of outgoings it would be reasonable to expect the borrower to cease.

367. The third approach, removal of paragraph (d) from the definition of 'listed outgoings' altogether would mean the lender would not be required to consider any regular or frequently recurring outgoings in the estimation of likely relevant expenses, beyond financial commitments, debt payments and living expenses.

368. This approach would provide the greatest discretion to lenders as to what, if any, additional expenses they consider aside from those required. However, there is a risk that lenders could miss some material outgoings that a borrower may not cease to avoid hardship. There may be considerable social or cultural commitments to make some payments – for example, for some borrowers have outgoings such as tithing or overseas remittances that cannot be cut off or reduced. In addition, expenses associated with addictions such as gambling or smoking are not essential living expenses, but are also not easily ceased. This could be mitigated by including additional guidance in the Code.

6.2.1.2.2 Changes to revolving credit contract calculations

369. As discussed in Chapter Five, regulation 4AL(2) sets out a prescriptive approach for lenders to estimate the expenses that may arise from revolving credit contracts. This does not take into account borrowers who use these facilities for day-to-day transactions and pay them off each month, rather than making large purchases to be paid back over months or years. This could result in 'double counting' of both the assumed debt payment on the revolving credit contract and the regular expense being paid under the revolving credit contract. This is particularly the case for BNPL facilities, as BNPL payments are paid off over a shorter period.

370. Further changes to the Regulation could be explored to address this issue by making amendments to provide the lenders with the discretion to exclude:

    a. revolving BNPL facilities from relevant expenses, and/or

    b. existing revolving credit facilities from relevant expenses if the borrower routinely repays them without incurring interest.

371. It is worth noting that the government is conducting a review of BNPL and considering whether BNPL should be regulated as a consumer credit contract under the CCCFA[10]. The outcome of this review is likely to affect views on the appropriateness of excluding BNPL products from relevant expenses.

372. Both these changes would remove double counting and resulting overestimation of likely relevant expenses, they are likely to improve ease of access to credit.

373. However, the current treatment of repayments under revolving credit contracts is based on the fact that borrowers have access to credit up to the limit of existing facilities. By making changes there may by a risk that after a loan has been advanced, the borrower may change their usage of their existing revolving credit contracts in a way that creates a substantial new

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[10] *Buy-Now, Pay-Later*, MBIE

liability. For example, a borrower who has been paying for living expenses with a credit card may instead decide to make a large one-off purchase.

6.2.1.2.3 Changes to the exception for variations and replacement of existing contracts

374. Regulation 4AH provides an exception from a full affordability assessment where lenders refinance or consolidate debts owed to themselves. However, there are situations where borrowers facing financial difficulty seek to refinance or consolidate debt from other lenders. The current scope of regulation 4AH may be limiting access to safe credit in these instances. This has the potential to contribute to financial hardship or could contribute to a delay in access to credit in situations which may be time sensitive as lenders are required to conduct a full affordability assessment.

375. To address this, regulation 4AH could be expanded to include credit contracts from other lenders, where total repayments are lower in the new arrangement.

376. This change would improve ease of access to safe credit and has the potential to benefit consumers, as there are instances where refinance or debt consolidation from one lender to another can reduce harm, for example by reducing the interest rate and extending the repayment term so debt is less costly and more manageable.

377. However, it creates some risk to consumer protection for some borrowers if it encouraged unscrupulous lenders to provide unaffordable debt consolidation services in circumstances where borrowers would be better off seeking hardship relief from their existing lender. This is mitigated by the general lender responsibilities in the CCCFA and liability regime.

6.2.1.2.4 Providing a new exception for 'emergency credit'

378. In some circumstances borrowers require quick access to small amounts of credit to deal with unexpected expenses or other sources of financial difficulty. While there is continued availability of support from Ministry of Social Development (Work and Income), Whānau Ora and charities, these alternatives can take longer to arrange, which may be an issue if the borrower is in an emergency situation.

379. This could be addressed by providing a new exception to the regulations for provision of emergency credit.

380. Allowing lenders to provide new agreements for emergency credit is likely to improve ease of access to credit. This is particularly important for emergency situations as limiting or delaying access in these circumstances can contribute to harm and substantial hardship.

381. However, a drawback of this approach is that it would likely reduce consumer protection for some borrowers. Whilst the provision of emergency credit may provide temporary relief to a borrower it brings the potential of lenders providing credit which is unaffordable. There is also the risk that expanding the exception in this way would contribute to debt spiralling (where borrowers must continue borrowing to pay off previous debts). This risk could be mitigated to some extent by, for example, including a condition that the lender has received information about how the borrower expects to move on from the emergency situation.

6.2.1.2.5 Changes to the requirement to satisfy that it is likely that the borrower will make repayments without suffering substantial hardship

382. Regulation 4AF(2)(b) requires lenders to be satisfied that a borrower will make repayments under the agreement without suffering substantial hardship because the borrower's likely income exceeds likely relevant expenses. Furthermore, lenders must apply either a reasonable surplus (4AF(2)(b)(i)) or a buffer (4AAF(2)(b)(ii)) to address the risk of overestimation of income, underestimation of expenses, or that the borrower may need to incur other expenses that cause them financial hardship. Where surpluses or buffers are applied where adjustments have already been made, this may be contributing to overly conservative estimates which contribute to declines or reductions in access to credit.

383. Further changes to the Regulation could be explored to address this.

384. One approach could be to amend the Regulations and Code so that 4AF(2)(b) only applies to certain kinds of lending, lenders, or type of borrower where there is greater risk of substantial hardship (or using another kind of characteristics such as those suggested in the approaches set out for targeting the scope of the affordability regulations). In all other cases the lenders could be directed to make their assessment as to whether it is likely the borrower can meet repayments without substantial hardship, taking into account the inquiries made under 4AF(2)(a).

385. Another approach could be to amend the Regulations and Code and remove 4AF(2)(b) completely. This would remove the overall requirement for lenders to ensure they are satisfied that a borrower will make repayments under the agreement without suffering substantial hardship because the borrower's likely income exceeds likely relevant expenses, as well as the requirement to apply either a reasonable surplus or buffer.

386. In general, both of these approaches would increase ease of access to credit for consumers as it would remove, or reduce the application of, the prescriptive requirement. This would mean lenders would have greater discretion in assessing loan affordability.

387. Consumer protection for some borrowers would be decreased with both of these approaches because the lack of the requirement brings the potential to approve loans where likely expenses exceed likely income, and the overestimation of likely income and underestimation of likely expenses. This risk is mitigated through the lender responsibility principles still applying and the design of the approach, such as the first approach where 4AF(2)(b) would still apply to high-risk lending and in all other cases lenders still be required to take into account the inquiries made under 4AF(2)(a) when assessing whether or not it is likely the borrower can make repayments without suffering substantial hardship.

388. These approaches are mutually exclusive to one another.

6.2.1.2.5.1 Narrowing scope of 4AF(2)(b) to certain kinds of lending, lenders, or type of borrower

389. There is likely to be an increase in ease of access to credit for consumers as lower-risk lending would no longer be subject to the requirement to be satisfied that a borrower will make repayments under the agreement without suffering substantial hardship because the borrower's likely income exceeds likely relevant expenses.

390. There would be greater discretion for lenders under this approach as it would allow lenders to consider other factors which may be more relevant in a particular circumstance such as nature and size of credit, character of borrower and history of relationship. It would also increase discretion and decision-making ability as lenders have designed their systems to decline borrowers who do not meet the threshold, even where there may be other mitigating factors.

391. Consumer protection for some borrowers is likely to decrease with this approach. Whilst there may be an increased risk for certain types lending, there is potential to overestimate for all kinds of lending, lenders, or types of borrowers. Nevertheless, there are other means by which risk of underestimation of expenses is mitigated, such as under regulation 4AM(2)(b) where in the adjustment of the initial estimate of a borrower's likely expenses lenders must use the higher of the initial estimate and benchmark for benchmarkable expenses.

392. As part of the initial changes, we are already proposing to make changes to the guidance in Chapter 5 of the Code that sets out how lenders may apply a reasonable surplus to comply with regulation 4AF(2)(b)(i). The initial changes will include further clarification in the Code on what a reasonable surplus may entail, how it may be applied, and the provision of examples.

393. We also note lenders are not required to apply both a reasonable surplus and buffer. Lenders may choose to apply either a reasonable surplus or a buffer to likely income and relevant expenses, in order to address the risk of overestimation of income, underestimation of expenses, or that the borrower may need to incur other expenses that cause them financial hardship. This means lenders do not need to apply a surplus or a buffer if they can adequately address this risk through the use of the other.

6.2.1.2.5.2 Removal of 4AF(2)(b)

394. Whilst some lenders may still follow a similar process to that prescribed in 4AF(2)(b) when estimating likely income and expenses, removing this requirement will allow lenders to make less conservative estimates of a borrowers' likely relevant income and expenses and is therefore likely to increase access to credit for consumers. There is likely to be a greater increase in discretion for this approach compared to narrowing the scope of 4AF(2)(b) as all lenders would no longer be required to be satisfied that a borrower will make repayments under the agreement without suffering substantial hardship because the borrower's likely income exceeds likely relevant expenses, and the requirement to apply either a reasonable surplus or buffer in all circumstances.

395. A drawback of this approach is that it is likely to reduce consumer protection for some borrowers. The requirements to ensure that a borrower's likely income exceeds likely relevant expenses and the applying of either a reasonable surplus or buffers are measures to prevent the approval of unaffordable loans which could contribute to substantial hardship. The absence of these requirements could increase access to unaffordable credit and reduce protection for consumers. For example, if a reasonable surplus is not applied some borrowers are at greater risk of substantial hardship where they need to incur other expenses, for instance as a result of an unforeseen life event.

396. Although there are other means by which risk of underestimation of expenses is mitigated, such as under regulation 4AM(2)(b) where in the adjustment of initial estimate of a borrower's

likely expenses lenders must use the higher of the initial estimate and benchmark for benchmarkable expenses, this may not sufficiently address the risk of removing 4AF(2)(b).

6.2.2 Repeal regulations

397. Repealing the affordability and suitability regulations would result in a return to the principles-based model which was used prior to 1 December. This would need to be done alongside changes to the Code to provide guidance on how lenders may meet the lender responsibility principles in Section 9C of the Act, for instance guidance on the recommended minimum inquiries.

398. Repealing the affordability and suitability regulations would improve ease of access to credit as lenders would no longer be required to conduct an affordability assessment in the prescribed manner. A return to a principles-based model would mean lenders would have far greater discretion in how they conduct affordability assessments to meet the lender responsibility principles.

399. However, it is likely to reduce consumer protection for some borrowers where lenders have less rigorous affordability assessments. The 2018 Review found that under the pre-1 December 2021 principles-based model, some non-bank lenders would only accept income and expense information provided from borrowers without proper verification and approve subsequent loans without carrying out affordability checks again. This led to a small number of consumers accessing credit that they could not afford to repay.

400. This is what the changes to the CCCFA, and in particular the prescriptive requirements on how affordability assessments should be conducted, sought to address. Prior to the changes the principles-based nature of the lender responsibilities in the CCCFA were identified by stakeholders as contributing to problems with non-compliance, particularly for non-bank lending. This is to say when legal obligations are not clear, they can be difficult to apply and for the regulator to enforce. Whilst changes to the Code to provide additional guidance may address this, it may also be limited due to its non-binding nature.

6.2.3 Changes to the liability regime provided in the Act

401. The settings for the liability regime, in conjunction with directors and senior managers due diligence duties, have shaped the way in which lenders have interpreted and applied the requirements in the Regulations. As discussed in Chapter Five, where lenders have adopted a conservative interpretation, this has been a key driver for unintended impacts, particularly where lenders are dissuaded from applying the exception.

402. As discussed in Chapter Three, the process changes some lenders have made to comply with directors and senior manager duties indicate they have either misinterpreted or been unable to implement effective processes which, in some instances, is resulting in them going above and beyond what was expected of them. For example, some lenders suggested that under their new process loans now require sign off approval from senior managers and directors.

403. In our estimation the overly conservative behaviour by lenders is attributable, at least in part, to the new liability regime and due diligence duties. Further work could be conducted on whether to change the penalties and liability regime.

404. Possible approaches could be to:

a. Reduce the onerousness of the due diligence duties for directors and senior managers of creditors under section 59B of the Act, and/or

b. Reduce penalties and liability settings for breaches of the Act under sections 107A – 107E and 88 – 92. For example, reduction in penalties amount and/or allowing directors to indemnify themselves against liability;

405. This approach is likely to result in a decrease in conservatism from lenders as there would be less risk upon directors and senior managers. However, we consider that conservative interpretation could be addressed through other potential changes which address specific issues with the design and drafting of the Regulations, and which provide additional guidance of how lenders may satisfy the responsible lending principles and conduct inquiries in the Code.

406. A drawback of this approach would be a reduction in consumer protection for some borrowers. If directors and senior managers were to be subject to less due diligence duties it would reduce incentives for directors and senior managers to oversee compliance. This has the risk of contributing to non-compliance.

407. This approach would decrease incentives for lenders to comply with the lender responsibilities and would increase the risk of non-compliance and decrease protection for consumers from irresponsible lending.

408. There would be reduction in confidence in consumer credit markets as it would mean that serious breaches would no longer incur serious penalties, or penalties as serious as they were before. We also acknowledge that the impact on confidence in consumer credit markets depends on enforcement action being taken to send a signal to the industry that there is a real threat of financial penalties.

6.3 Further areas to be considered

6.3.1 Business lending

409. Part of the definition of ‘consumer credit contracts’ is that the credit is to be used wholly, or predominantly, for personal, domestic or household purposes (in addition to other conditions, such as the lending being to a natural person). This means that, in general, lending for business purposes is not caught by the CCCFA.

410. However, MBIE has been told that borrowers who use credit for the purpose of investing in a business are sometimes subject to the same processes that lenders apply to consumer credit and are therefore being adversely impacted by CCCFA changes that restrict access to credit. We have heard that this is a particular issue where borrowers obtain business credit secured over their home. There may also be situations in which a credit contract is used predominantly

for personal purposes, but part of the money received is used for business purposes. In theory, changes that improve ease of access to credit for consumers would likely increase access to credit for businesses who are subject to the same processes.

411. Lenders should be able to improve processes for businesses independent of any changes to the CCCFA and Regulations, given that credit contracts entered into for business purposes are already excluded from the CCCFA. We consider that there is merit in undertaking further work on this in the context of broader work on enabling businesses to access credit.

Annex One: Investigation into the impacts of recent changes under the Credit Contracts and Consumer Finance Act 2003 – Terms of Reference

Context

In response to recent concerns, the Minister of Commerce and Consumer Affairs has asked the Council of Financial Regulators (CoFR) - Kaunihera Kaiwhakarite Ahumoni (Ministry of Business, Innovation and Employment Hīkina Whakatutuki, Reserve Bank of New Zealand Te Pūtea Matua, Financial Markets Authority Te Mana Tātai Hokohoko, Commerce Commission Te Komihana Tauhokohoko and The Treasury Te Tai Ōhanga) to conduct an investigation into the initial implementation of recent changes to the Credit Contracts and Consumer Finance Act 2003 (CCCFA) that came into force on 1 December 2021. This investigation will be led by MBIE with critical input from other CoFR agencies.

Objective

The objective of the investigation is to identify any impacts of the recent CCCFA changes that came into force on 1 December 2021, considering the scale and nature of the impacts, to assess what, if any, further actions are needed.

Role of CoFR agencies

MBIE as the relevant policy agency will lead the investigation, including engagement with stakeholders, in collaboration with CoFR agencies. CoFR agencies will provide input to the investigation as well as review and feedback on the conclusions and recommendations of the draft and final reports in accordance with their relevant functions.

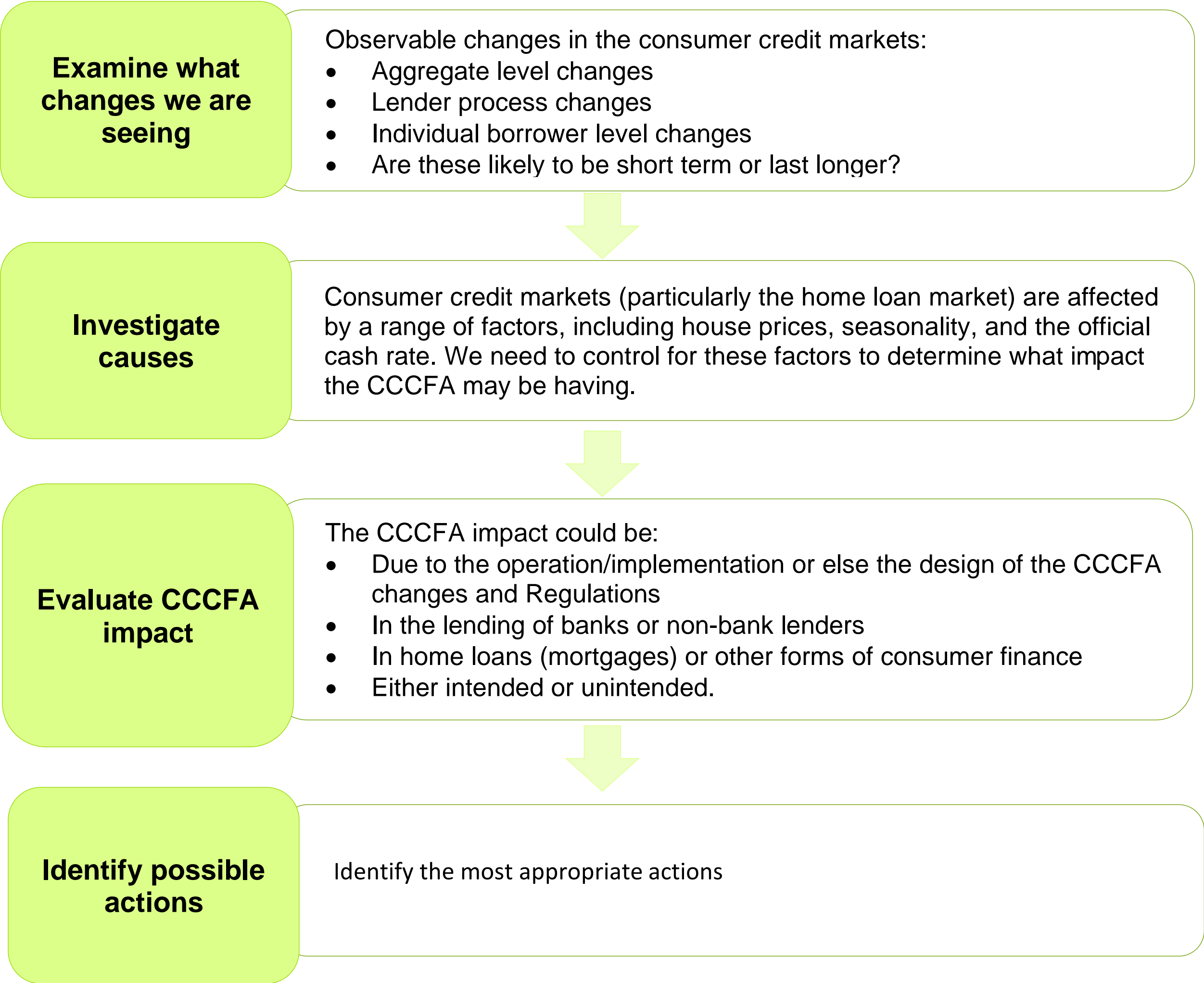
Scope

The scope of the investigation is to look at the intended or unintended impacts, beyond those expected by the initial implementation, of the parts of the Credit Contracts Legislation Amendment Act 2019 and Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020 that came into force on 1 December 2021 primarily in relation to mortgage, but also other lending, by banks and nonbank lenders in the current consumer credit market.

Lines of inquiry

The proposed lines of inquiry set out in Figure One overleaf seek to identify and gather available relevant information to discover potential impacts and identify if there are any potential problems that warrant further consideration. A potential outcome is that more work will likely need to be done to fully understand actual impacts. Indicative timeframes Initial advice is anticipated in early-mid February, followed by further advice in April.

Figure One: Lines of Inquiry



Annex Two: Investigation into the initial implementation of CCFA changes: Stakeholder questions

Questions for bank/non-bank lenders and intermediaries

Part One: About the implementation process

- Please describe how your implementation process has gone to date:
  - How has your organisation found the implementation of the new regime? 'Are there aspects of your implementation that required particular innovation??
  - How have you educated and approached capability development of personnel required to implement the changes?
  - What has been the most challenging aspect of the implementation? Are there any areas where more clarity may be warranted?
  - What have been the benefits of implementation?

Intermediary / broker specific question

- Please describe any changes you may have noticed in loan application requirements? Please provide specific examples and/or data.
- Are there any differences between the lenders you work with (eg. bank and non-bank lenders), in how they are working under the new rules?
  - What are applicants/borrowers doing when they are declined? (eg. changing their spending, getting support from a financial coach or mentor to do this, applying for credit elsewhere)

Part Two: Impacts on consumer / clients

- What consumer / customer feedback have you been receiving?
  - What have been the main challenges for consumer / customer?
  - Are particular consumer / customer groups (eg first home buyers, Māori, retirees etc) being affected differently?
  - If yes, in what way? What have been the main drivers?
  - Has there been any change in applicants ‘giving up’ partway through the loan application process?
- What could be done to address the main challenges, whilst continuing to ensure loans are affordable and suitable?

- What are your views about the concerns expressed in the media? (e.g. customers being told they have been denied loans due to particular expenses, concerns about invasiveness, advice to 'hide' expenses, or impacts of life changes like children)

Part Three: Impacts on loan approval timeframes and rates

- Have your lending decisions or risk appetite changed since 1 December?
  - What has been driving the changes?
  - How has this been reflected in your processes?
- Where have the main changes been to your loan approval times or approval vs decline rates since the recent changes came into effect?
  - Home loans [where applicable to the specific lender] – Could you please describe what is impeding the loan process and approval? Would you be able to share data with us on changes in approval timeframes, approval rates and reasons for declining loan applications?
  - Other consumer loans - – Could you please describe what is impeding the loan process and approval? Would you be able to share data with us on changes in approval timeframes, approval rates and reasons for declining loan applications?
  - Pre-approvals - Did you decline any loans that had received a pre-approval prior to December 2021? For those borrowers who received pre-approval prior to December but were subsequently declined a loan (if this applies), what were the key factors driving the change?
- In your view, what are the main challenges?

Part Four: Specific changes to loan approval processes

- What are the specific steps that have changed in your loan approval process?
  - Especially interested in categorisation of expenses, treatment of one-off expenses and other expenses which potential borrowers might be expected to cut back on
  - Especially interested in changes in sources of information about expenses, and methods used to verify or assess the reasonableness of expenses
- What further operational changes are expected, if any, and over what timeframes, to facilitate the implementation of the new lending requirements?

Part Five: Other concurrent factors

- What other factors are at play in the lending environment (outside of CCCFA regulation) which may affect your rate of loan approvals vs declines, processing times? e.g. seasonal variation, increased OCR, reduced affordability

Part Six: Looking ahead

- What additional guidance might assist lenders and you with the operationalisation of the new CCCFA regime?
- What actions could be taken to address the challenges you and your consumer / clients are facing whilst continuing to ensure loans across the credit industry are affordable and suitable? (e.g. narrowing the scope of the regulations and what types of loans they apply to, greater guidance in the Responsible Lending Code)

- What will change or stay the same over the medium term if no regulatory changes are made?'

Questions for dispute resolution schemes, financial mentors and consumer-focused organisations

Part One: About the implementation process in general

- How has your organisation / clients found the implementation of the new regime?
- What has worked well?
- What are the general issues with the implementation process that you've heard of?
  - Have you observed greater difficulties for borrowers wanting to access finance since the recent changes came into effect?
  - To what extent do you think these difficulties are justified by underlying affordability issues, versus unwarranted changes in lender practices?
- What are your views on lender's capability to implement the changes?

Part Two: Impacts on consumer / clients

- What specifically has changed for borrowers when wanting to access finance?
  - e.g. having to provide more data to lenders
- What consumer / customer feedback have you been receiving?
  - What have been the main challenges for consumer / customer?
  - Are particular consumer / customer groups (eg first home buyers, Maori, retirees etc) being affected differently?
  - If yes, in what way? What have been the main drivers?
  - Has there been any change in applicants 'giving up' partway through the loan application process?
  - What other sources of finance are applicants/borrowers turning to?
- What are your views about the concerns expressed in the media?

Part Three: Other concurrent factors

- What other factors might be at play in the lending environment (outside of CCCFA regulation) which may be affecting loan applicants? e.g. seasonal variation, reduced affordability

Part Four: Looking ahead

- What additional guidance might assist lenders and you with the operationalisation of the new CCCFA regime?
- What actions could be taken to address the challenges you and your consumer / clients are facing whilst continuing to ensure loans across the credit industry are affordable and suitable? (e.g. narrowing the scope of the regulations and what types of loans they apply to, greater guidance in the Responsible Lending Code)
- What will change or stay the same over the medium term if no regulatory changes are made?